Tolley®CPD

September 2014

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1. CORPORATION AND BUSINESS TAX (LECTURE B851 – 14.15 MINUTES)

1.1 Corporation tax rates

Section 5 imposes corporation tax for the 2015 financial year. Section 6 confirms that the small profits rate is 20% for the year, and sets the marginal relief fraction at 1/400. It also sets the ring fence profits rate at 19% (unchanged) with a related marginal relief fraction of 11/400.

Finance Act 2013 set the main rates for both 2014 (21%) and 2015 (20%) financial years, and Finance Act 2014 makes no changes to these rates.

Schedule 1 of the Act implements the changes to move corporation tax to a single rate (with the exclusion of ring fenced profits on oil activities). It makes structural changes to CTA 2010 to impose a single rate – called the main rate to distinguish from the ring fenced rates (there remain two rates applying to ring fenced profits – 30% and 19%). The Schedule removes all references to "small profits"

In removing the small profits rate material, there is a restructure of a number of rules which point towards associated companies and the upper profits limit. As the marginal relief content has to be retained for ring fenced profits, we now find the (unchanged) upper and lower limits in that part of CTA 2010. One key change, however is essential for smaller companies and their advisers.

1.1.1 New concept – related 51% group company

Instead of using the associated companies term, a number of areas of legislation – including the Quarterly instalments payment legislation in SI 1998/3175 now reference to a new section within the ring fenced profits rules – s279F CTA 2010. This replaces the requirement to divide the upper limit by the number of associated companies +1, with a similar adjustment based on related 51% group companies.

A company B is a related 51% group company of company A if:

- A is a 51% subsidiary of B,
- B is a 51% subsidiary of A, or
- Both A and B are 51% subsidiaries of the same company.

The rules about associated companies are carried across, so that companies are related 51% group companies for the whole of their accounting periods, and companies are not counted if they do not carry on a trade or business throughout the accounting period.

This means that for the purposes of the quarterly instalment payment regime, a company will only be required to pay corporation tax by instalments if either its profits exceed £1.5 million for more than one accounting period in succession, or if it has a number of related 51% group companies so that the limit is reduced to below the corporation tax profits for two periods in succession. Note that the trigger to instalment payments is £10 million in the first period to avoid companies falling into the regime unexpectedly.

Other areas of corporation tax where the term associated companies has been replaced by the new concept are :

- CAA 2001 s 99 – dividing the monetary de minimis of £100,000 for long life assets
- CTA 2010 s 357CL – patent box, companies permitted to elect for small claims treatment, and s 357CM, small claims amount

The changes apply to the 2015 financial year, with spanning periods to be treated as two separate accounting periods although the last two mentioned apply to accounting periods commencing on or after 1 April 2015.

1.2 Annual Investment Allowance

Section 10 deals with the increase in AIA to £500,000 from 1 April (6 April for income tax). The current rates of AIA are therefore

- £250,000 from 1 January 2013 until 31 March 2014 for companies, and 5 April 2014 for income tax businesses, and
- £500,000 from 1 April 2014 for companies and 6 April 2014 for income tax businesses until 31 December 2015.
- £25,000 thereafter (at present).

Schedule 2 deals with the transitional rules (amending FA 2013 which dealt with the last change) for both the start date and 1 January 2016.

1.2.1 Opening transitional periods

These periods span the start date – 1 April 2014 for companies and 6 April 2014 for income tax businesses.

The amount of allowances for the whole period is computed on a time apportioned basis using the relevant limits.

There is then a restriction on AIA available against expenditure in the period falling before the start date, assuming that this does not start before 1 January 2013 (separate rules apply). The maximum AIA in that part of the period is the amount that would have been available had this most recent change not been made. In practice, therefore, irrespective of the length of the part period before the start date, this amount will be £250,000.

Example 1

For the year ended 31 December 2014, a company will have the following AIA:

Total amount for the accounting period

(3/12 x £250,000) + (9/12 x £500,000) = £62,500 + £357,000 = £437,500

Within this limit, the period 1 January 2014 to 31 March 2014 suffers a restriction to £250,000 (not £62,500 as might have been expected).

1.2.2 Closing transitional periods

This is where the rules can catch the ill-advised out, as there is an unexpected restriction in the latter part of an accounting period.

Once again the total AIA for the period is found by time apportioning the relevant limits.

This time the restriction on the part period falls at the end of the AP – at that part of the period falling after 31 December 2015. The maximum AIA in this part of the period is the time apportioned amount calculated for the purposes of the total limit.

Example 2

For the year ended 30 June 2016, the maximum AIA for the whole period is

(6/12 x £500,000) + (6/12 x £25,000) = £250,000 + £12,500 = £262,500

However, the allowance available for expenditure between 1 January 2016 and 30 June 2016 is only 6/12 x £25,000 = £12,500.

As businesses frequently incur capital expenditure towards the end of their accounting periods, this needs to be planned for in advance, and clients warned to make the expenditure before 1 January 2016.

1.3 Avoidance involving the transfer of company profits

Section 30 prevents avoidance by the transfer of profits between members of the same group of companies. Under it, two companies A and B which are members of the same group and are party to arrangements which are, in substance, a payment (directly or indirectly) from A to B of all or a significant part of the profits of the business of A. If the main purpose, or one of the main purposes of the arrangements is to secure a tax advantage for any person involving the profit transfer, then A's profits are calculated as if the profit transfer had not occurred. (new section 1035A CTA 2009).

This measure is intended to support a change made in relation to a similar scheme obtained through a derivative contract known as a total return swap. That scheme was closed by section 695A CTA 2009, which was introduced by section 29 and came into effect from 5 December 2013. This deals with similar effects achieved by other means, and commences on 19 March 2014.

1.4 Research and development tax relief : SME scheme

Section 31 increases the rate of payable tax credit under the SME scheme from 11% to 14.55 of the surrendered loss in respect of expenditure incurred on or after 1 April 2014.

The payable amount therefore increases as follows:

Expenditure £1,000 x 225% = £2,250. Surrendered as a loss at 11% = £247.50 or 24.75% of the original expenditure. Surrendered as a loss at 14.5% = £326.25, or 32.6% of the original spend.

1.5 Improvements to film tax relief

Section 32 makes changes to the film tax relief scheme in CTA 2009 as follows:

- Section 32(2) reduces the required percentage of core expenditure in the UK from 25% to 10%.
- Section 32(3) changes the film tax credit on surrendered losses from 25% for limited budget films and 20% otherwise to provide a band of £20 million at 25% for all production companies and 20% thereafter. (There is a limit of 80% core expenditure at 25% in addition).

The commencement date for these changes will be announced by Treasury Order.

1.6 Other creative sector reliefs

Minor changes have also been made to television tax relief and video games development relief, in the case of the latter principally to extend the relief to the EEA rather than restricting it to the UK.

1.7 Company donations to CASC's

Section 35 introduces tax relief for company donations to community amateur sports clubs (CASC's), with a related anti-avoidance test in new s202B CTA 2010.

Section 202B reduces the relief on a payment to a club where the company making the payments is wholly owned or controlled by the club or by a number of charities including the club for the whole or part of the period and inflated member-related expenditure is incurred by the company in that period. The amount of inflated member-related payments reduce the payment in that period to nil and then are carried back against payments made in the preceding six years, taking the most recent periods first.

New section 202C defines inflated member-related expenditure. This means:

- Employment expenditure incurred in respect of a member of the club by the company where that employment is other than on an arm's length basis, and
- Expenditure on the supply of goods and services to the club by a member of the club or a member controlled body other than on an arm's length basis.

If, however, the non-arm's length features taken together are beneficial to the company then no adjustment is made.

1.7.1 Examples from the Explanatory notes to the Bill.

Example 1

A company, owned and controlled by a CASC buys supplies from one CASC member and rents property from another. Both of the payments are more than what would be expected under an arm's length arrangement. As a result CASC members benefit financially to the detriment of the company and its parent sports club.

In the accounting period ended 31.01.16, the subsidiary incurred total costs of £37,500 and £12,500 for the supply of sporting equipment and rent, respectively. In respect of the same accounting period the subsidiary made a qualifying gift of its entire net profit of £75,000 to the CASC.

Because neither of the arrangements was at arm's length the value of the qualifying gift would be reduced by £50,000 (37,500 + £12,500). Accordingly, the subsidiary would become liable to pay corporation tax in respect of profit of £50,000, rather than nil, despite the company donating its entire net profit to the CASC.

Example 2

A contract agreed between a CASC controlled company and a CASC member provides for two supplies for a total figure of £100,000. An arm's length transaction would have cost £25,000 for each supply. It is impossible to know how the £100,000 is allocated to each supply in this case, therefore the whole of the £100,000 will be treated as Inflated Member Related Expenditure.

The changes apply to gifts on or after 1 April 2014, but the carry back provision cannot apply to periods ending before that date.

1.8 Tax relief for theatrical productions

Section 36 and Schedule 4 introduce a new tax relief for theatrical productions.

Schedule 4 introduces new 15C into CTA 2009, the whole of which deals with theatrical production tax relief, and runs from section 1217F to 1217OB. A brief summary of the relief follows.

Relief is available to a production company in relation to a theatrical production (which includes a ballet), but only a single company can qualify for relief in relation to any production. Theatrical production is defined, and apart from a ballet, the production must be a dramatic production in which the actors, singers, dancers or other performers are to give their performance through the playing of roles, where each performance during the proposed run will be live, and the presentation of the performances is the main object or one of the main objects of the production company's activities in relation to the production.

The rules exclude productions including wild animals, which are advertisements, which are a competition or which are of a sexual nature. Also excluded are productions where the main purpose is to film them.

25% of the core expenditure must be incurred in the EEA, and any qualifying production is treated as a separate trade. The additional deduction is 100% of the EEA expenditure incurred, up to a total maximum of 80% of the core expenditure. On incurring a loss, this may be surrendered for payable tax credit of 25% for touring productions and 20% for non-touring productions.

The rules also include commerciality tests, and anti-avoidance rules.

1.9 Changes in company ownership

Various corporation tax provisions are triggered by a change in company ownership. Section 37 inserts new s724A into CTA 2010 to relax the current rules and ensure that if a new ultimate holding company is introduced at the top of a group, the rules are not triggered. It applies to a change in ownership on or after 1 April 2014.

1.10 Tax exemption : Glasgow Grand Prix

Section 47 introduces an exemption from income tax for non-resident individuals competing in the Glasgow Grand Prix athletics competition, which ran from 5 – 14 July 2014. The exemption applies to income arising from competing in the games, and other activities to support the games within the games period given above. Section 48 can be regarded as related, as it allows tax exemptions to be given by Regulation in future in respect of major sporting events in the UK.

1.11 Enterprise Zone capital allowances

Special 100% capital allowances for certain expenditure in designated areas within enterprise zones were introduced in 2012. The scheme is very restrictive and applies only to new spend on expansion, and not to replacement plant and machinery. The scheme was due to terminate in 2017, and will now run through to 31 March 2020, the extension being made by section 64, which also enables this and other favourable capital allowance regimes (such as that for low emission cars and zero emission goods vehicles) to be time extended by Treasury order.

Note that the list of assisted areas has been updated, and BIS has available the final maps and lists of the new assisted areas 2014 – 2020. This has been approved by Europe and is effective from July 2014.

1.12 Business premises renovation allowance (BPRA)

Changes have been made by section 66 to ensure that the BPRA scheme is effectively targeted, and to reduce the period for balancing adjustments from seven to five years.

Section 360B of CAA 2001 is amended, and the definition of qualifying expenditure has been replaced. Capital expenditure must be incurred before the expiry date to qualify and must meet conditions A and B, and must not be excluded by subsections (3), (3B) or (3D).

1.12.1 Condition A

The expenditure is incurred on

(a) the conversion of a qualifying building into qualifying business premises
(b) the renovation of a qualifying building if it is or will be qualifying business premises
(c) repairs to a qualifying building, or where the building is part of a building, to the building of which the qualifying building forms part, to the extent that the repairs are incidental to the expenditure in (a) or (b).

1.12.2 Condition B

The expenditure is incurred on

(a) building works
(b) architectural or design services
(c) surveying or engineering services
(d) planning applications, or
(e) statutory fees or statutory permissions

Condition B is treated as met if any other expenditure falling outside the list does not exceed 5% of the amounts incurred under (a) to (c) in total.

1.12.3 Excluded expenditure – fixtures

The excluded expenditure in relation to fixtures, set out in subsection (3) – which now refers to new subsection (3A), where the list appears is as follows:

a) integral features or part of such a feature
b) automatic control systems for opening and closing doors, windows and vents
c) window cleaning installations
d) fitted cupboards and blinds
e) protective installations such as lightning protection, sprinkler systems, fire alarms and fire escapes
f) building management systems
g) cabling for telephone, audio visual, data and computer networking which are incidental to the occupation of the building
h) sanitary appliances and bathroom fittings which are hand driers, counters, partitions, mirrors or shower facilities
i) kitchen and catering facilities for producing and storing food and drink for the occupants of the building
j) signs
k) public address systems
l) intruder alarm systems

1.12.4 Excluded expenditure – market value test

Expenditure is excluded by new subsection (3B) if and to the extent it exceeds the market value amount for the works, services or other matters to which it relates. Market value is defined by new subsection (3C) setting it at an arm's length price in similar market conditions.

1.12.5 Excluded expenditure – building occupied

New subsection (3D) also excludes expenditure if the qualifying building was used at any time in the 12 months ending on the day the expenditure was incurred.

1.12.6 Delay in carrying out works

Where expenditure is incurred in advance of works being done, and allowances are claimed at that time, the expenditure and the allowances are unwound if the works are not completed within 36 months of the date the expenditure was incurred. If the works are subsequently completed, the expenditure is re-recognised at the date the works are completed. (new section 360BA)

1.12.7 Grant aid

New section 360L excludes from allowances any expenditure which has been supported by a relevant grant or relevant payment, either directly, or a grant to any person in respect of expenditure incurred on the same building and on the same single investment project. This extends to three years after the expenditure is incurred, in which case the allowances are clawed back. Claimants are required to notify HMRC so that returns can be amended or assessments raised.

Relevant grant or relevant payment are defined as grants or payments which are State Aid, or other grants or payments which the Treasury by order declares are relevant to this section.

The changes in this section (i.e. the whole of section 66 FA 2014) take effect from 1 April 2014 for companies and from 6 April 2014 for income tax, but in relation to grant aid to a grant or payment received before those dates but in relation to expenditure incurred on or after those dates.

1.13 Transfer pricing – compensating adjustments

When a transfer pricing adjustment has been made to increase a company's profits it is possible for the other party to the transaction to claim a compensating adjustment – that is a corresponding reduction in taxable profits. Section 75 introduces new s 174A into TIOPA 2010 which prevents the compensating adjustment being claimed when the disadvantaged person is in charge to income tax on profits and the advantaged person is a company.

By way of compensation, if the adjustment relates to interest, the excess amounts paid which are disallowed under s174A will be treated as a distribution under new s187A. The commencement date for these changes is 25 October 2013.

1.14 Companies and employee-ownership trusts (Lecture B852-11.12 minutes)

Schedule 37 introduces new reliefs in relation to trading companies owned by employee ownership trusts.

Para 1 introduces new s 236H into TCGA 1992, which provides for no gain no loss treatment of a disposal by a person P of ordinary share capital of a company C to the trustees of a settlement meeting the relief requirements. The relief must be claimed.

1.14.1 Relief requirements

a) C is a trading company or the principal company in a trading group (activities test) and continues to be so for the remainder of the tax year of disposal

b) The settlement meets the all employee benefit requirement – broadly that the only possible beneficiaries of the trust are all of the employees and officers of C or a group company, and is not permitted to make loans to the beneficiaries. Beneficiaries must benefit on the same terms. Participators holding at least 5% are excluded beneficiaries. It must meet this requirement at the time of transfer and for the remainder of the tax year.
c) The settlement does not meet the controlling interest requirement (more than 50%) at the end of the tax year before the year of disposal, but it meets it at the end of the year of disposal. If met during the year, it must continue to meet it for the remainder of the year.
d) The limited participation requirement is met, and
e) That this section does not apply to any related (C or another group company) disposal by P or a person connected with P in an earlier tax year.

The limited participation requirement limits the number of participators in C in the 12 months following the disposal to 2/5 as follows:

(People who are participators and also employees or officers of C + people who are connected to them and also employees and officers of C) / employees of C

Part 2 of the Schedule introduces an exemption from income tax for up to £3,600 per employment on a qualifying bonus payment in any tax year. The qualifying bonus payment must be one made to its employees (and any qualifying former employees) by a company which is owned directly or indirectly by a trust of the type specified in Part 1 at the time of the payment and which meets the qualifying conditions. A qualifying bonus payment will be an award other than regular salary or wages that is paid to all employees of the company (or the group of which it is a member) on equal terms, although bonus amounts can be set by reference to a percentage of salary or length of service or hours worked.

Part 3 of the Schedule makes amendments to inheritance tax provisions to support the creation and operation of the trust. It ensures that transfers to the trust and the trust itself are exempt from inheritance tax charges in cases where the conditions for the existing exemptions which apply to employee benefit trusts are not met.

2. INCOME TAX (LECTURES P851 / P852 – 14.02 MINUTES / 14.10 MINUTES))

2.1 Tax rates and thresholds 2014/15 onwards

Section 1 of the Act deals with rates of tax and personal allowance and basic rate band for 2014-15. Section 2 deals with the basic rate band and personal allowance for 2015-16, and abolished the separate personal allowance for those born between 1938 and 1948. Section 3 deals with the changes to the starting rate for savings, which will be implemented for 2015-16.

Table 1 : rates and limits for tax 2014/15 and 2015/16

	Note	2014/15	2015/16
Personal allowance		10,000	10,500
Age related allowance : lower amount	1	10,500	N/A
Age related allowance : higher amount	2	10,660	10,660
Income limit for personal allowance		100,000	100,000
Income limit for age related allowances	3	27,000	Not known
Starting rate for savings	4	10%	0%
Starting rate band	4	2,880	5,000
Basic rate band (20%)		31,865	31,785
Higher rate limit (40%)		150,000	150,000
Additional rate		45%	45%

Notes to Table 1

1. The lower amount of age related allowance is available to persons born between 6 April 1938 and 5 April 1948.
2. The higher amount of age related allowance is available to those born before 6 April 1938.
3. Only the excess over the basic personal allowance is tapered
4. The rate applies to savings income within the band, provided the taxable non savings income does not exceed the limit of the band.

Section 4 changes the basis of indexation for personal allowances, basic rate band and the starting rate for savings to the consumer prices index from the retail price index from 2015-16 onwards.

2.2 Transferable allowance for married couples and civil partners

Section 11 introduces Chapter 3A comprising new ss 55A to 55E into ITA 2007. It frames the allowance as available when the other party to the marriage or civil partnership has elected for a reduced personal allowance.

2.2.1 Entitlement to tax reduction

New s 55B states when an individual is entitled to a tax reduction at the appropriate rate (set as the basic rate to which the individual would be charged to income tax for the year):

- The individual is married to or in a civil partnership with a person who has made an election under s55C which is in force for the tax year (the spouse or civil partner)
- The individual is not liable to tax at any rate other than the basic rate, the dividend ordinary rate or the starting rate for savings for that tax year
- The individual meets the residence requirements of s56 (right to claim a personal allowance – includes non-resident EU nationals at present), and
- Neither the individual, nor their spouse or civil partner makes a claim to married couples allowance for the year.

An individual can only benefit from one tax reduction in any tax year (s 55E).

The transferable amount for 2015/16 is set at £1,050, and thereafter at 10% of the personal allowance, rounded up to the next £10.

If an individual is entitled to a tax reduction, their partner's personal allowance is accordingly reduced, unless the recipient dies during the year. In that event the benefit is received without the reduction affecting the other partner.

2.2.2 Election to reduce personal allowance

An individual can make an (a single – s55E) election to reduce their personal allowance if they are married to or in a civil partnership the same person for the whole or part of the tax year, and at the time the claim is made. They must also only be liable to basic rate, dividend ordinary rate or the starting rate for savings after their personal allowance has been reduced.

Where a non-resident is entitled to claim personal allowances and seeks the benefit of this section, there is an additional test to ensure that were they UK resident and domiciled, their nest income would be taxable only at basic, dividend ordinary or the starting rate for savings.

Elections must be made within four years after the end of the tax year concerned, and remain in force until withdrawn (by giving notice). However, an election made after the end of the tax year applies only to the year of election.

If the spouse or civil partner does not obtain a tax reduction as a result of the election, the election lapses, but can be re-instated in respect of the same or another marriage or civil partnership.

Normally when notice is given of withdrawal of an election, this takes effect from the next tax year unless the marriage or civil partnership has come to an end through divorce (decree absolute), order of judicial separation, decree of nullity or in the case of a civil partnership, a dissolution order or order of nullity or order of separation.

2.3 Recommended medical treatment

Section 12 inserts s 320C into ITEPA 2003 providing for an exemption from benefit in kind tax for recommended medical treatment up to a value of £500 in any tax year The exemption applies to both direct provision by the employer (including by non-cash vouchers) and reimbursement to the employee, provided it does not form part of a flexible benefits package nor is in relation to salary sacrifice arrangements.

Recommended medical treatment must be provided to the employee as part of the occupational health services provided to the employee by a service provided under s 2 of the Employment and Training Act 1973, or by or in accordance with arrangements made by the employer and is made for the purpose of assisting the employee to return to work after a period of absence due to injury or ill health. Regulations will specify the period of time for which the employee has been unfit for work, and any other additional conditions.

2.4 Relief for loan interest

The current provisions (s392 ITA 2007) allowing relief for interest on a loan to purchase an interest in a close company are extended by s13 to include EEA resident companies that would be close if they were resident in the UK.

Section 14 makes a similar extension in relation to interest on loans to purchase an interest in an employee-controlled company – extending the relief to unquoted companies resident in the EEA (s 396, 397 ITA 2007) which meet the relevant definitions.

Section 13 also introduces a new definition of a close investment holding company for this purpose at new s 393A. Loans to purchase an interest in a close investment company do not attract relief for interest under s 392.

2.4.1 Close investment holding company – new definition

New s 393A introduces this definition for the purposes of ss 392 and 393 of ITA 200 in relation to interest paid in the tax year 2014-15 and subsequent years. Given the move to a single rate of corporation tax, this will remain one of the important differences in treatment between close companies and close investment holding companies.

A close company (“the candidate company”) is a close investment company in an accounting period unless throughout the period it exists wholly or mainly for one of the following permitted purposes:

- Carrying on trade or trades on a commercial basis
- Making investments in land or estates, or interests in land in cases where the land is or is intended to be let on a commercial basis

- Holding shares in and securities of, or making loans to one or more companies, each of which is a qualifying company, or which is under the control of the candidate company and exists wholly or mainly for the same purpose
- Co-ordinating the administration of two or more qualifying companies
- Trade or trades carried on on a commercial basis by one or more qualifying companies or by a company which has control of the candidate company

If a company is being wound up and was not a close investment holding company in the period before the winding up started, it will not be a close investment company (for the purposes of ss 392 and 393) in the period after.

A qualifying company is a company under the control of the candidate company which exists for the purposes of trade or letting land (see above – first two purposes).

2.5 Remittance basis – dual contracts

Section 15 and Sch 3 change the basis of taxation from the remittance basis to the arising basis in respect of employment income for overseas duties where it is considered that artificial separation of the duties of an employment has occurred. Under this approach, the overseas duties are set up in a separate contractual arrangement.

Sch 3 brings the related employment income (including income related to employment related securities and options) into charge on an arising basis on UK resident but non domiciled employees if certain conditions are met. Broadly, these are:

- an individual has both a UK employment and one or more "relevant" (i.e. foreign) employments;
- the UK employer and the relevant employer are "associated" with each other;
- the UK employment and the relevant employment are "related"; and,
- the foreign tax rate that applies to income in respect of a relevant employment, calculated in accordance with the amount of foreign tax credit relief which would be allowed against income tax if the income were not taxed on the remittance basis, is less than 65% of the UK's additional rate of tax (currently 45%).

2.6 Onshore employment intermediaries

Section 16 amends the treatment of certain workers provided by agencies to make the workers employees of the agency. Where the worker provides services personally and is under the supervision, direction or control of the client, who has contracted for the services, then the worker is treated as an employee of the agency, unless the client or a relevant person provides a fraudulent document purporting to prove that this provision does not apply. (Amended s 44 ITEPA 2003, with anti-avoidance provisions in new s 46A).

2.6.1 Personal liability for "relevant" PAYE debts

The existing legislation in social security law which makes directors of a company personally responsible for unpaid NIC has been extended to "relevant" PAYE by section 17 FA 2014. It allows HMRC to issue a personal liability notice on any director of a company that has failed to deduct, account for or pay over relevant PAYE at the time the company is required to do so. The notice will specify both PAYE and interest thereon, which the director must pay within 30 days of the notice.

Relevant PAYE is PAYE which arises under new s 44(4) to (6) or 46A ITEPA 2003, which was introduced by s 16 FA 2014 – see 2.6 above. The provisions in s44(4) to (6) relate to the issue of a fraudulent document claiming that s44 does not apply to an arrangement.

2.6.2 Information powers

Section 18 introduces new s 716B into ITEPA 2003 which provides HMRC with new information powers in relation to employment intermediaries. There is a requirement to keep, preserve and provide information, with associated penalties for failure.

2.7 Making good tax not deducted by the employer

Employees have a short time to make good tax not deducted by the employer on notional payments (from which tax cannot be deducted) including payments under the Employment Related Securities legislation. Section 19 FA 2014 extends the time period, as recommended by the OTS, from 90 days to the end of the relevant tax year. The change applies to payments of income treated as made on or after 6 April 2014.

2.8 Beneficial loans – limit

The limit on a loan which is disregarded as a benefit in kind has been increased to £10,000 by section 22. The new limit applies to the tax year 2014-15 and subsequent years.

2.9 Cars – the appropriate percentage

The benefit in kind rate applying to company cars with various emissions ratings are again uprated by Finance Act 2014, s 24. This year, the changes affecting 2016-17 are implemented, with the key changes being:

- Abolition of the uplift for diesels, with consequential amendment to the maximum rate for diesel cars, which was set at 3% below the other maximum
- Increasing the rates for cars without an emissions rating, and for those registered before 1 January 1998
- Changing the minimum benefit on the main table to 15%, and

- Increasing the favourable rates for very low emission cars by 2% each.

So the following rate of benefit in kind will apply from 2016-17.

2.9.1 New rates – cars with no emissions rating

Engine size	2015-16	2016-17
1400cc or less	15%	16%
1400 cc to 2000 cc	25%	27%
Over 2000 cc	37%*	37%

* Increased from 35% by Finance Act 2013 for 2015-16

2.9.2 New rates – cars registered before 1 January 1998

Engine size	2015-16	2016-17
1400cc or less	15%	16%
1400 cc to 2000 cc	22%	27%
Over 2000 cc	32%*	37%

Cars without a cylinder capacity – 37% (was 32%)

2.9.3 Main table of benefit in kind rates

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

* announced but not yet legislated for

2.10 Pensions reform

Chapter 4 of Finance Act 2014 deals with the changes to the taxation of pensions from 27 March 2014. Obviously, these changes are part of a much wider reform of pension provision, but the wider measures will not be legislated for until 2015, as there has been a consultation on this over summer 2014.

2.10.1 Maximum drawdown pension

Section 41(1) increases the maximum drawdown pension to 150% of the Government Actuary's annuity rates for pension drawdown years starting on or after 27 March 2014. Section 41(2) makes a similar change in respect of dependants' drawdown pension on the death of the member.

2.10.2 Flexible drawdown

An individual may draw any amount from his pension drawdown fund provided he has a guaranteed amount of other income in retirement. Section 41(3) reduces the limit to £12,000 for declarations by those seeking flexible access to the fund from 27 March 2014.

2.10.3 Trivial commutation

The trivial commutation limit allows the member to take his pension fund as a lump sum if his total pension savings do not exceed the limit. Section 42(1) increase the limit to £30,000 for commutation periods commencing on or after 27 March 2014.

2.10.4 Small pension pots

Regardless of their total pension savings, where any pension pot is less than the small pot limit of £2,000 the whole amount can be taken as a lump sum. The limit is increased to £10,000 by section 42(5). The current maximum number of pension pots to which this rule can apply is also increased to three by section 42(6)(d). The changes apply to amounts paid out on or after 27 March 2014.

There are other changes in Schedule 5 to Finance Act 2014 which provide for the transition through 2014 to the changes proposed for 6 April 2015. These changes are of relevance to scheme administrators and pensions specialists.

2.11 New lifetime allowance 2014-15

Schedule 6 deals with the transitional arrangements in relation to the reduced lifetime allowance from 6 April 2014, and introduces new Individual protection 2014, which is intended to be more flexible than fixed protection. Individual protection 2014 (IP14) is not available if the individual already benefits from:

- Enhanced protection

- Fixed protection 2012, or
- Fixed protection 2014

In each case, the individual is already offered better protection from tax charges than is offered by IP14.

IP14 allows the lifetime allowance to be set as follows:

- If the individual's relevant amount is more than £1.5 million, the greater of the standard lifetime allowance and £1.5 million, or
- Otherwise, the greater of the standard lifetime allowance and the individual's relevant amount.

An election to benefit from IP14 must be made by 5 April 2017.

An individual's relevant amount is the sum of A, B, C and D.

A – deals with the value of pensions in payment prior to 6 April 2006.
B – deals with the value of any pre 6 April 2014 benefit crystallisation events
C – deals with the value of uncrystallised amounts in registered pension schemes at 5 April 2014
D – deals with the value of uncrystallised amounts in relieved non-UK pensions schemes at 5 April 2014.

2.12 Pension scheme regulation

Schedule 7 introduces new requirements on pension schemes, including powers for HMRC to require information or documents with related penalties for failing to comply of providing inaccurate information, and various other regulatory powers connected with applications for registration, deregistration, and trustee liabilities. It will be of interest only to those directly involved in the administration of registered pension schemes.

2.13 SIP's increased limit

Section 49 increases the limit on free shares awarded annually in a Share Incentive Plan (SIP) from £3,000 to £3,600. The maximum deduction form an employee's salary in relation to partnership shares rises from £1,500 to £1,800. The changes take effect on 6 April 2014. Section 50 permits similar changes in future to be made by Treasury Order.

2.14 Administration of employee share schemes

Schedule 8 makes major changes to the administration of share schemes. Under this, schemes will no longer be approved by HMRC, but will self certify and notify HMRC of the scheme. So the following terms will now apply:

- Instead of Approved SIP, a plan will be referred to as a Schedule 2 SIP
- Instead of an approved SAYE option scheme, a scheme will be known as a Schedule 3 SAYE option scheme.

- Instead of approved CSOP schemes, a scheme will be referred to as a Schedule 4 scheme.

Schedule 8 then includes various administrative requirements about notification, annual returns, enquiry, penalties and appeals which will affect those running the appropriate schemes. All notices and returns must be given electronically.

To some extent the changes also affect EMI schemes and other employee shares schemes, so that a single set of obligations and powers apply to all schemes.

2.15 Employment related securities – unapproved share schemes

Schedule 9 makes a number of changes to the employment related securities legislation (in accordance with the recommendations of the OTS). These are not dealt with in detail in these notes.

Part 1 of the schedule deals with changes to the taxation of employment related securities and options in relation to internationally mobile employees – defined as those subject to the remittance basis, or non-resident or UK resident for the year but in the overseas part of a split year.

Part 2 of the Schedule introduces a new relief for exchanges of ERS securities, and simplifies the treatment of nil paid and partly paid securities.

Part 3 of the Schedule extends the relief available for corporation tax on shares provided through employee share schemes to situations where employees are seconded to the UK "employer" by a company not in charge to UK corporation tax. Further relief may also be available to a UK employer where shares are obtained by an employee as a result of overseas employment.

2.16 Venture capital trusts (VCT's)

Schedule 10 makes a number of changes to VCT legislation in ITA 2007 as follows:

- Para 1 introduces a time limit on HMRC raising an assessment to withdraw VCT relief, setting this at six years after the end of the affected tax year, overriding the standard limit in TMA 1970 (amends s 270);
- Para 2 restricts relief where a subscriber makes a "linked sale" of shares in the VCT or a predecessor VCT (new s 264A)
- Para 3 withdraws approval from the VCT if it makes payments representing a return of capital or share premium within 3 years after the issue of the shares (amends s 281)
- Para 5 permits relief to be obtained by an individual where shares are subscribed for on their behalf by a nominee (new s 330A).

2.17 Seed EIS

Sections 54 and 55 remove the time limits on relief for investments through SEIS. Section 54 deals with the income tax relief, and section 55 the CGT reinvestment relief.

2.18 EIS, VCT – excluded activities

Section 56 excludes from EIS and VCT investments companies carrying on activities of the subsidised generation of heat or subsidised production of gas or fuel. (amends ss 192, 303 ITA 2007, with definitions in new ss 198B, 309B)

It also replaces the definition of subsidised generation of electricity with one which includes the receipt of a FIT subsidy or a renewables obligation certificate has been issued, or similar schemes outside the UK (amends s198A ITA 2007).

2.19 Social investment tax relief (Lecture P853 – 21.45 minutes)

A 30% income tax incentive will be provided on investments in qualifying social enterprises. The measure was originally planned in Budget 2013, and is included in Finance Act 2014 at Schs 11 and 12 which introduce new Part 5A (ss 257J to 257TE) into ITA 2007. This provides 30% of the amount invested as a deduction from tax payable for the year, starting from 2014/15. The investment must be in shares or qualifying debt in a qualifying enterprise, which must be held for at least three years.

A social enterprise is defined as:

- A community interest company
- A community benefit society (as defined) that is not a charity
- A charity
- An accredited social impact contractor (as defined)
- Any other body prescribed by Treasury Order.

In common with other tax incentivised investments, the investment itself will not carry any CGT liability on disposal after the qualifying period, and also provides for deferral of Capital Gains at the point of investment – the gains will be chargeable when the investment is disposed of. The qualifying conditions are largely based on EIS, with investment by employees or directors of the enterprise and linked companies not permitted, nor investment by those with at least 30% of the shares already.

Under EU rules governing the initial introduction of the social investment tax relief, individual enterprises can only receive a certain amount of government subsidised investment. The limit is €344,827 (about £290,000) over three years. The exact sterling equivalent is the spot exchange rate on the date of investment.

Individual investors can invest up to £1,000,000 per year and can invest in more than one social enterprise. This is independent of any investments under Seed Enterprise Investment Scheme and Enterprise Investment Scheme which are subject to their own annual investment limits.

Bodies seeking approval to raise funds under the Social Investment Tax Relief (SITR) scheme are able to apply for approval after Royal Assent. Organisations must have a defined and regulated social purpose. Charities, community interest companies or community benefit societies carrying out a qualifying trade, with fewer than 500 employees and gross assets of no more than £15 million may be eligible.

Other conditions and criteria also apply, which can be found in the HMRC guidance.

3. CAPITAL AND PROPERTY TAXES

3.1 CGT annual exempt amount

The annual exemption for 2014/15 is set by section 8 which excludes normal indexation and imposes a limit of £11,000.

Similarly, section 9 sets the limit for 2015/16 at £11,100, again excluding the effect of indexation.

3.2 Private residence relief

Section 58 reduces the final period of exemption from 36 months to 18 months for disposals of private residence on or after 6 April 2014.

Section 58 also introduces a new section 225E into TCGA 1992, to provide for a 36 month final exempt period where the disposer or their spouse is a disabled person or is a long term (three months) resident in a care home. The additional period only applies where the disposer or their spouse have a single PPR, and does not extend the period for those with more than one home.

3.3 Foreign gains – remittance basis

Section 59 corrects an error in TCGA 1992 and excludes from charge foreign gains arising in the overseas part of a split year for residence purposes. It is backdated to 6 April 2013, when the mistake was introduced.

3.4 Trusts for disabled beneficiaries

The CGT exemption for property coming into charge to IHT does not apply correctly to trusts where a disabled beneficiary is deemed to be a life tenant, only to trusts where there is an actual life interest. Section 60 corrects this anomaly and removes a tax issue which distorts decisions about which is the most appropriate trust structure to use.

3.5 CGT roll-over relief

Section 61 extends roll-over relief to farm subsidy payments under the new EC scheme, preserving an existing relief.

Section 62 corrects a mistake in tax law rewrite (CTA 2009) and removes roll-over relief for reinvestment of the proceeds of sale of a tangible asset into an intangible asset. The change also corrects the base cost of the intangible asset during the lacuna to prevent double relief being given, by adjusting its value on 19 March 2014. This affects claims relating to the period 1 April 2009 to 19 March 2014 when the correction takes effect. (New s 870A CTA 2009)

3.6 Avoidance involving capital losses

Section 63 tightens up the targeted anti avoidance rule in s184G of TCGA 1992 to ensure that it works as intended. In particular, it makes clear that both s 184G and s 184H cover arrangements implemented under any tax law, and not just TCGA. The relevant avoidance areas are converting income into capital and schemes securing an income deduction for capital losses. The changes apply to arrangements entered into on or after 30 January 2014, and arrangements entered into before that date where a chargeable gain arises on a disposal on or after that date.

3.7 ATED – reduction in threshold

ATED applies to enveloped dwellings, and was introduced in 2013 applying to properties valued at in excess of £2 million on 1 April 2012.

The threshold will reduce as follows :

- On 1 April 2015 the starting point for ATED will fall to £1 million, with an annual tax charge for 2015-16 of £7,000. The first returns (transitional year) will be due on 1 October 2015, with tax payable on 31 October 2015. After that returns and payment will be due on 30 April each year as for the existing scheme. (s109, amending s 94 FA 2013)
- On 1 April 2016 the starting point will fall again to £500,000 with an annual charge of £3,500. There is not presently a transitional year for this further extension, so one must assume that returns and tax are due on 30 April 2016 as for the existing scheme. (s 110 amending s 94 FA 2013).

3.8 Increased rate of SDLT

Mirroring the ATED extension, the higher rate of SDLT (15%) applying to residential property transactions with non-natural persons is also extended to apply to properties with a value of in excess of £500,000 (previously £2 million) where the effective date is on or after 20 March 2014 (s 111 amending Sch 4 FA 2003).

3.9 SDLT – charities relief

Section 113 and Schedule 23 make changes to SDLT relief for charities. The change provides partial relief for a charity joint purchaser where property is purchased jointly between a charity and a person who is not a charity. The relief is subject to a three year claw back if the charity ceases to be a qualifying charity during that time, or ceases to hold the land for charitable purtposes only.

3.10 IHT Threshold

Schedule 25 contains a number of IHT provisions. Para 2 fixes the nil rate band for IHT at £325,000 for the tax years 2015-16 to 2017-18 inclusive by disapplying statutory indexation.

3.11 FA 2013 – exclusion of debts in the estate

The measure introduced in FA 2013 to exclude debts in the estate where they financed non chargeable assets has been extended by para 3 Sch 25 to also exclude debts which finance the foreign currency bank accounts of non-residents which are excluded from the estate by s 157 IHTA 1984. It does so by adding new section 162AA, which permits the excess of the liability to be deducted from the estate only where there was no tax advantage motive.

3.12 Relevant property – ten year anniversary charge

Para 4 of Sch 25 makes changes to the relevant property (trust) provisions to include in the value of the property for the purposes of the ten year charge income which has arisen on relevant property at least five years before the charge is applied, and to which nobody is beneficially entitled through an interest in possession. This means that as income is rolled up in a relevant property trust, it will become subject to the ten year charge after between five and ten years of retention (depending on the timing of the ten year charge). (amends s 64 IHTA 1984)

Where the settlor is non domiciled this provision does not apply if the income is situated outside the UK or is represented by a holding in an authorised unit trust or share in an open-ended investment company.

3.13 Due date for returns and payment – trustees of relevant property trusts

Para 5 amends the due date for returns and payment of tax for tax charges arising under Chapter 3 of Part 3 of IHTA 1984 (charges on relevant property) to be six months from the end of the month in which the occasion of charge occurs (amending s216(6) IHTA 1984). The date tax is payable is now six months after the end of the month in which the chargeable transfer is made (amending s 226 IHTA 1984). Interest is charged on unpaid tax by virtue of the amendment to s 233 IHTA 1984.

4. VAT

4.1 Supplies of electronic, broadcasting and telecommunication services (EBT services)

Schedule 22 sets out the new scheme for dealing with supplies of EBT services both in the UK and in other member states, which will all adopt an equivalent scheme.

Taxable persons may register for the scheme (the Union Scheme) if all of the following conditions are met:

a) They make or intend to make one or more qualifying supplies of scheme services in the course of a business
b) Either their business is established in the UK, or if not established in any member state, they have a fixed establishment in the UK
c) They are not barred from registering by Article 369a(2) of Directive 2006/112/EC, and
d) They are registered for VAT in the UK.

A supply is a qualifying supply of scheme services if the recipient belongs in another member state (i.e. not the UK), and must not be a business, and the person making the supply must not have a fixed establishment in the member state in which the recipient belongs. HMRC must register those applying to register if they meet the conditions and provide the relevant information.

The new scheme is closed to any business registered under a non-UK special scheme, although services which fall to be taxed in the UK under the new place of supply rules will be accounted for through the non-UK special scheme.

4.1.1 Returns, liability and payment

Para 9 of Schedule 22 provides for quarterly returns, on which the gross amount of VAT is payable, according to the liability to VAT in the member state in which the recipient belongs. No deduction of input VAT is possible. Returns are to be made in sterling, and are due within 20 days of the end of the quarter. Returns will be electronic, and any currency translation is performed at the rate for the last day of the quarter (or next available date). Payment is due by the due date for the return (para 11).

4.1.2 Late payments and late returns

The rules about late returns and late payment impose default surcharge on members of non-UK special schemes who do not submit their returns on time in accordance with the non-UK scheme provisions. This makes it clear that if the return under the UK scheme is late, it will be the penalty regime in each separate member state that will be in force, rather than the UK penalty regime.

4.1.3 Example

A UK based business making supplies of software to individuals around the world currently accounts for UK VAT on supplies to individuals in the UK and EU.

From 1 January 2015 it will be required to account according to the member state of residence of the customer, and thus register and account for VAT in multiple EU member states. However, this can all be done on a single return via the Mini One Stop shop service. If the first return and payment are submitted after 20 April, the business will face potential penalties in each member state in which a relevant supply was made in the quarter ended 31 March 2015. The business can apply to register for the special scheme from 1 October 2014.

4.2 Belonging – refining the rule

Section 104 modifies the belonging rule for supplies which are supplied where the recipient of the services is. Section 9 VATA 1994 is amended to add to the term "usual place of residence" in s9(3)(c) a further qualifier of "or permanent address".

Similarly s9(5) is amended to read "belonging

a) In the country in which the person's usual place of residence or permanent address is (except in the case of a body corporate or other legal person);
b) In the case of a body corporate or other legal person, in the country in which the place where it is established is."

These changes take effect from 1 January 2015.

4.3 Other consequential changes – EBT supplies

The rule which makes supplies through an agent transparent will be disapplied from 1 January 2015 in relation to EBT services, so that a supply through an agent will be both a supply to the agent and a supply by the agent (s 106 amending s47 VATA 1994). This is essential to make supplies through the Apple iTunes store work effectively under the new rules, otherwise UK vendors would bear the cost of the VAT, and also the administrative burden of the change. As the agent is a business in Luxembourg, the new place of supply rules will not affect the UK vendor.

4.4 Prompt payment reform

The rules on the calculation of VAT where a prompt payment discount is offered by the supplier are amended by s 108 so that the VAT charged reflects the amount the customer pays for the supply. The change is necessary to align with EU rules, and will increase the VAT charged on the supply where the discount is not taken. The VAT shown on the invoice will be based on the gross value of the supply.

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

5. PARTNERSHIPS

5.1 Introduction

This issue was consulted on during the summer of 2013, and draft legislation was issued for comment in December 2013. The guidance supporting the measure was updated and amended in February 2014, and the measures present a significant tax challenge to many professional businesses.

The changes are dealt with by Schedule 17 to Finance Act 2014, which is divided into four parts:

- Part 1 Limited liability partnerships : treatment of salaried members
- Part 2 Partnerships with mixed membership
- Part 3 Alternative investment fund managers : deferred remuneration (not dealt with in these notes)
- Part 4 Disposals of assets through partnerships

5.2 LLP partners with fixed profit share

Para 1 of Schedule 17 introduces a new provision into ITTOIA 2005 at section 863A. This provides that when conditions A to C (in subsequent new sections 863B to 863D) are met in relation to M, a member of the LLP, then M is to be treated as employed by the LLP under a contract of service. M's rights and duties are to be construed accordingly as rights and duties under a contract of service.

The net effect of failing the test is that the individual concerned is brought within PAYE, and Class 1 NIC is due on earnings which have previously been taxed as a profit share. There may also be consequences for members of LLP's previously provided with company cars, as these will now be taxed as a benefit in kind. The "profit share" will be treated as a salary payment for the LLP (and for corporation tax purposes if relevant) and will therefore be a deduction in arriving at the taxable profits of the entity.

5.2.1 Condition A

New section 863B sets out first when Condition A is to be tested: these are, where there are relevant arrangements (arrangements under which M is to be paid for the performance of services for the partnership in his capacity as a member) in place:

a) At the start of the tax year 2014-15,
b) If later, when M becomes a member of the LLP
c) At any subsequent time when relevant arrangements are put in place or modified
d) The day after the end of the relevant period (see Step 1 below)

Subsection (3) then sets out how to determine whether Condition A is met. *Step 1* identifies the period (the relevant period) being assessed, which starts at the date of assessment (the relevant time) and ends at a time when it is reasonable to expect the arrangements will end or be modified.

Step 2 performs the test for the relevant period. Condition A is met, if at the relevant time it is reasonable to expect that at least 80% of the total amount payable by the LLP in respect of M's performance of services as a member of the LLP will be disguised salary.

An amount is disguised salary if it is

a) fixed,
b) if it is variable, it is varied without reference to the overall amount of profits or losses of the LLP, or
c) is not, in practice, affected by the overall amount of those profits or losses

If condition A is met or not met at the relevant time, it is then treated as met or not met until it is required to be re-examined as described above.

The application of condition A is illustrated in the Explanatory notes to the Bill as follows:

Example 1

M becomes a member of an LLP on 1 July 2014 and arrangements are made that in return for working for the LLP M will receive a fixed salary for the period from 1 July 2014 to 30 June 2015. It is expected that a new annual arrangement will be put in place from 1 July 2015.

The relevant time at which condition A is to be determined is 1 July 2014 being the date when M became a member and the relevant pay arrangements were put in place. The relevant arrangements are the pay arrangements for the period from 1 July 2014 to 30 June 2015. The relevant period is from 1 July 2014 to 30 June 2015. The latter date is the date on which it is expected that the arrangements will end. M's services are the work that M will do for the LLP in the capacity as a member in the period from 1 July 2014 to 30 June 2015.

On 1 July 2014, it is expected that M will receive a fixed salary for the period 1 July 2014 to 30 June 2015. It is therefore reasonable to expect that at least 80% of the amount payable for M's services under the arrangements in place for that period will be disguised salary and condition A will be met. The determination will apply until the end of 30 June 2015 unless the arrangements change during the period.

5.2.2 Condition B

Set out in new section 863C, condition B is that the mutual rights and duties of the members of the LLP, and of the partnership and its members do not give M significant influence over the affairs of the partnership.

5.2.3 Condition C

At the relevant time (the time at which it is being determined whether condition C is met), M's contribution to the LLP is less than 25% of the total amount of disguised salary which it is reasonable to expect will be payable by the LLP in respect of M's performance in the relevant tax year of services as a member of the LLP.

Normally the relevant time is the start of the tax year; commencing with 2014-15, but where M joins the partnership it will be at that date for that tax year only. If M's contribution to the partnership changes at any time, or if anything else occurs that might impact on whether Condition C is met or not, the question is re-assessed at that point. However, where the condition is assessed on the increase of capital to the partnership, in order to change the outcome from "met" to "not met", it is necessary to consider the remainder of that tax year. (see new s 863D(7)).

Where M joins a partnership part way through the year, the period during which he was not a member is referred to as excluded days. When considering condition C, the contribution to the partnership is scaled by the fraction

$$(D – E)/D$$

Where D is the number of days in the tax year and E is the number of excluded days. A similar scaling factor is also applied when M is not, at the relevant time, expected to remain a member of the partnership for the remainder of the tax year, and also when M's contribution to the partnership increases part way through the tax year.

5.2.4 Contribution to the partnership

Sections 863E and 863F set out the definition of a contribution to the partnership, and deemed contributions to the partnership.

The contribution is defined as A, the amount of capital M has contributed to the partnership, less any amounts drawn back, or which he is entitled to draw back while still a member or have reimbursed. Accumulated profit is treated as a contribution to the extent added to capital (and not available to draw).

Deemed contributions allow M to undertake to contribute capital which at the relevant time has not be paid over. This allows a contribution to be taken into account provided it is paid:

- By 5 July 2014, or

- Within 2 months of becoming a member of the LLP, if later

In this case, paying the contribution during the time stated does not trigger a re-assessment on condition C, as it was originally assessed as if the promised contribution had been paid at the (earlier) relevant time. If M fails to make the contribution before the end of the time allowed, condition C is at that time reassessed, taking into account any part of the promised contribution that has been paid.

The deemed contribution rules are illustrated in the Explanatory notes to the Bill as follows:

Example 2

M is an existing member of an LLP at 6 April 2014 who has not previously contributed capital to the LLP. On 5 April 2014, M gives an undertaking to the LLP that he will make a contribution of £50,000 by 5 July 2014. The contribution when made would constitute amount A in new section 863E. The question whether condition C is met is determined on 6 April 2014 and takes into account the deemed contribution of £50,000 resulting in condition C not being met. On 30 June 2014, M contributes £50,000 to the LLP.

This contribution does not trigger a re-determination and condition C is treated as not met until the end of the 2014-15 tax year or unless there is a later change that requires a redetermination.

Example 3

M is an existing member of an LLP at 6 April 2014 who has not previously contributed capital to the LLP. On 5 April 2014, M gives an undertaking to the LLP that he will make a contribution of £50,000 on 5 July 2014. The contribution when made would constitute amount A in new section 863E. The question whether condition C is met is determined on 6 April 2014 and takes into account the deemed contribution of £50,000 resulting in condition C not being met. M fails to make any of the contribution by 5 July 2014. On 6 July 2014, the question whether condition C was met at 6 April 2014 is revisited. M is not treated as having made a contribution so condition C is met. M also met conditions A and B on 6 April 2014 so is treated as a salaried member from that date.

5.2.5 Anti-avoidance rules

Section 863G sets out the anti-avoidance rules associated with this measure.

- No regard is to be had to any arrangements, the main purpose of which (or one of the main purposes of which) is to secure that the provisions do not apply to one or more individuals (new S863G(1))

- There is a provision which is designed to prevent M from routing his services through a limited company. This is triggered when an individual (X) performs his services when not a member of an LLP, though Y, who is not an individual but is a member of the LLP. Y is paid amounts which would amount to employment income of X were X an employee of the LLP. In these circumstances, S 863G(4) deems X to be a member of the LLP and the amount receivable by Y in respect X's services as employment income of X (with a consequential income tax disregard for any income actually paid from Y to X).

Finally new s863C(4A) excludes this provision where arrangements have been put in place to avoid the new rules on profit sharing arrangements in mixed partnerships in new S850C ITTOIA 2005 (see below). This therefore ranks s 850C before s863A. This is the sole part of this legislation which commences on a date other than 6 April 2014. The start date is Royal assent – 17 July 2014.

5.2.6 <u>Deductions in the partnership accounts</u>

As a result of deeming what would have been taxable profits of the partnership to be employment income, consequential changes are needed to compensate for this.

New section 94AA in ITTOIA 2005 provides for deductions for expenses that are paid in respect of M which would not otherwise be deductible. A similar new section (92A) is inserted into CTA 2009, and in both cases the amendment is reflected across into computation of the profits of a property business, in addition to the trading deduction specifically given. The CTA 2009 amendment also applies to companies with an investment business, adding this deduction to the list of allowable management expenses for an investment business.

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

5.2.7 <u>Illustrative examples from HMRC guidance issued in February 2014</u>

The examples form part of the guidance notes supporting the legislation, and a selection is reproduced here to aid understanding.

<u>Condition A : Example 1</u>
John is a member in an LLP which has entered into an agreement to develop a property over a three year period. The agreement provides that John will receive a fixed profit share of £100,000 per year for the first two years and then 50% of the profit from the development, expected to be £500,000 in total. This arrangement is not changed.

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

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

Although, as events have turned out, John has received only a salary, this is only the result of an extraneous event. As the parties expected and intended for John primarily to be rewarded through a share in the overall profits of the LLP, John is not at any time a Salaried Member.

Example 2
X used to be an active member of JKL LLP but reduced his active work a number of years ago and has not provided any services to the LLP for a year. In recognition of his contribution to the partnership over his career, X remains a member of the LLP, continuing to receive a profit share.

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

Example 3
M is a member of the BYBY LLP. He has been approached by, and accepted, a more senior role with the Hello LLP.
Under the terms of the LLP Agreement, M will leave the BYBY LLP in three months' time. The Management Board agrees to commute M's expected profit share into a fixed sum, based on profit projections, and M is placed on "gardening leave" for three months.

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

Example 4
The B LLP is formed between the B family and a local developer to develop a plot of land. Kate B is a member of the B LLP, but under the LLP agreement, she does not need to work for the B LLP.

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

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

<u>*Example 9*</u>
This example highlights that it is important to focus on whether, on **a realistic view**, the amount represents a share of the overall profits, so that the profit share that member gets will vary on the basis of the overall profits of the LLP.

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

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

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

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

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

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

To illustrate this, consider how the share P receives may be affected by the profits of the LLP as a whole:

Due to a professional negligence claim, the value of a unit is much lower than last year. As a result, although P has had an exceptional year and has been allocated more points than last year, her share of the profit is £20,000 less than the previous year.

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

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

For the purposes of this legislation, the question is what are the terms governing the remuneration committee's exercise of its discretion in determining the bonus payable. If the bonus is paid out of shares of the profit, then that is a share of the profit for the purposes of the legislation. In this case, more information is needed - what are the terms of reference for the committee? How realistic is it that any profit share will be 25% or more than the fixed salary of £100,000 (such that 80% of the total rewards will be).

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

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

Disguised salary: Example 25
The XYZ LLP decides to expand into a new business area. A new member, P, is recruited to run the new business area. As it is expected that the new business area will initially make a loss, P will receive a guaranteed profit share of £100,000 plus a percentage of the turnover of the new business area.

Neither the guaranteed profit share nor the payment based on a percentage of the turnover of that business area is based on the profits of the LLP as a whole. Condition A is satisfied.

Profit share

A disguised salary includes both fixed amounts and amounts that are determined without reference to the level of profits or losses for the LLP as a whole. As a result, a disguised salary includes any sum that the member is reasonably expected to receive whether or not the LLP makes sufficient profit.

The key point is not how the payment is described; rather that it is a sum that the member expects to receive and will not in practice vary with the profit even if it is expressed to be linked to profit. It may be theoretically possible that a member is required to repay part of their drawings, or that the firm may make a loss, but if these are unlikely events, they will be ignored.

Here are some examples of arrangements which will be regarded as guaranteed profits:

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

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

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

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

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

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

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

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

Reasonable likelihood : Example 13
Four people decide to set up a cafe together. Members A, B & C do not have any capital to invest so only put in £100 each. The fourth, Member D, provides the funding for the venture. They agree that Members A, B & C will each have a salary of £25,000 a year. The agreement is that these are not repayable even if the profits are under £75,000.

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

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

Condition B

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

Example 29
The Family Farm LLP has as members, a couple, A & B, and their adult son, X. The LLP Agreement has not been amended since before X was admitted. The way that the LLP operates in practice is that A, B and X all have a say in the running of the business, with A having a casting vote.

Although the written agreement was not amended when X was admitted, the implied terms of the agreement under which X was admitted was that he would have a significant say in the business. As a result, Condition B is not satisfied and X is not a Salaried Member. It is unlikely that this Condition will exclude many members of very large partnerships, since, in such cases, it is likely that only a minority of individuals have significant influence over the affairs of the whole partnership.

Management committee

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

Example 34
Up until 1 June 2014, E was the managing partner of GH LLP, a large professional services firm. Upon reaching the age of 60, E decided that she wanted to retire. F was appointed as the new managing partner but F and the other members were keen to retain E's experience in order to mentor F and provide a smooth transition.

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

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

Although it seems that Conditions A and C of the test could be met in light of her move from a variable to a fixed profit share and the withdrawal of her capital, the circumstances are that she will clearly have significant influence over the affairs of the partnership for the whole of this period. Therefore, Condition B will not be met, meaning that Conditions A and B will not need to be considered; E will not be treated as a salaried member.

Condition C

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

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

Contributions

The amount of capital contribution is based on the amount that the individual has invested as capital at that time in accordance with the LLP Agreement.

- It does not take into account sums that the individual may be called upon to pay at some future date.
- It does not take into account undrawn profits unless by agreement they have been converted into capital.
- It does not take into account sums that are held by the LLP for the member, for example, sums held in a taxation account.

Example 41

P has:

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

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

<u>General examples</u>

<u>Example 1</u>
50 people currently work for the A LLP, of whom forty-five are listed as members. The A LLP business plan is inclusive, recognising that everyone working for the business is contributing to the success of the business; hence once it is clear that the individual is going to stay with the business, they are invited to become a member.

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

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

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

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

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

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

5.2.8 <u>Financial implications</u>

Assume that a 6 partner LLP has three members who are on a fixed salary of £100,000 each. The following tax implications will arise on the partners as a result of the change. We shall also assume that each of the three has a car with list price of £25,000, and emissions such that the benefit in kind rate is 22%. Previously, only 50% of the running costs of £5,000 per annum (including fuel) have been allowed for tax purposes. The tax written down value of each is £23,000, and the market value is £18,000.

On salaried partners

<u>Tax charge</u>

Tax charge on profits of £100,000 vs salary of £100,000 is unchanged. There is a cash flow issue, as the salary is received net of tax, but as previously self-employed individuals, the tax was paid under self-assessment.

There is a new tax charge on the benefit in kind on the car, unless the car is disposed of. The benefit in kind is £5,500 per annum. It is unlikely that the partners will accept free fuel for private motoring, as it is unlikely to be beneficial. There will be a beneficial effect of the LLP bearing the running costs (other than fuel) which were previously a private expense – this will affect the remaining partners as it will reduce their taxable profit.

National insurance contributions

The self-employed contributions (2014/15 rates) would be 52 weeks x £2.75 = £143
Class 4 contributions on £100,000 would be (at 2014/15 rates) total £4,215, so total NIC charge on the partner is £4,358.

Contributions paid by the employee under class 1 would be £5,232, an increase of £874 per annum.

So the total additional tax and NIC borne by the salaried partners would be between £3,074 and £4,174, depending on whether the partner falls into the 60% band or not.

On the rest of the firm

The allocation of profits which are now taxed as salary have no tax effect on the remaining partners, as both reduce the remaining profits available to the "equity" partners. However, the NIC charge is significant:

Employer NIC on £100,000 salary is £12,702. In addition, there will be a charge to NIC on the company car benefits of £759 per salaried partner.

So if the firm bears the additional costs of the partners being reclassified as employees, the additional costs will be £40,383, although these additional costs will be tax deductible on the firm (or the remaining partners). There will be some savings in additional capital allowances, which will now be available at 100% rather than the business proportion of 50%. The figures are unlikely to be material in relation to the figures quoted above.

Other thoughts

It is possible that the remaining partners would seek to mitigate the additional employer NIC costs by reducing the fixed profit share still further, so that the net cost is the same as the previous deduction for the fixed profit share. This would reduce the fixed profit share to £88,838, (ignoring the effect of the car) leaving the fixed profit share partners £6,697 per annum worse off (net of tax and NIC – assuming the rate of tax is 40%).

5.3 Profit sharing in mixed partnerships

This measure is intended to deal with partnerships where there is a member not subject to UK income tax (normally a limited company). HMRC is concerned that these structures are being used to avoid tax on a significant scale. The new legislation is introduced as ss 850C to 850E ITTOIA 2005.

5.3.1 Detailed provisions

The legislation seeks to attribute profits to a member of a partnership (whether an LLP or any other type of partnership) where it is considered that those profits have been sheltered in a non – individual member (usually a company, but in fact any member of the partnership that is not an individual, so this would include a trust) for tax purposes.

The provisions attack the allocation of profit as follows :

- A, an individual member of a partnership has been allocated a share of the profit, or a zero result (but not a loss) for an accounting period, and
- There is a non-individual member (B) of the partnership, which has also been allocated a share of the profit for the period, and
- Condition X or condition Y is met.

5.3.2 Condition X

It is reasonable to suppose that amounts representing A's deferred profit are included in B's profit share, and in consequence, A's profit share and the relevant tax amount are lower than they would otherwise have been.

Deferred profit is defined by new s850C(8) means any remuneration, benefits or returns the provision of which to A has been deferred, whether conditionally or otherwise.

The relevant tax amount is defined by s850C(9) is the total amount of tax which would otherwise be charged on A and B's income as partners in the firm, apart from this section.

5.3.3 Condition Y

- B's allocation of profit is in excess of the appropriate notional profit, and
- A has the power to enjoy B's profit share (referred to as A's power to enjoy), and
- It is reasonable to suppose that the whole or any part of B's profit share is attributable to A's power to enjoy, and both A's profit share and the relevant tax amount are lower than they would have been had it not been for A's power to enjoy.

5.3.4 Counteraction

If Condition X or Y is met, then s850C(4) requires that A's profit share is increased by so much as B's profit share as it is reasonable to suppose is attributable to A's

- Deferred profit, or
- Power to enjoy.

The amount reallocated to A will be determined on a just and reasonable basis, but cannot reduce B's allocation below the "appropriate notional profit". The operation of the allocation first applies deferred profit share, and then A's power to enjoy.

5.3.5 B's appropriate notional profit

The legislation (s 850C(10)) allows B (the non-individual member of the partnership) to be allocated a share of profits without disturbing them. This share is capped at the sum of:

- A return on capital equivalent to a commercial rate of interest on the capital contributed by B to the firm (less amounts paid in respect of this which are not part of B's profit allocation) (s 850C(11) to (13)), plus
- A return for services provided to the firm by B (but not involving any other partner of the firm in addition to B) less any amounts actually paid otherwise than as an allocation of profit priced on an arm's length basis (s 850C(15) to (17)).

5.3.6 A's power to enjoy

Defined in new s 850C(18) to (21), A has the power to enjoy B's profit share if:

- A is connected with B under s993 ITA 2007 (definition of connected persons) with the exclusion of the connection arising from mutual partnership, or
- A is party to arrangements the main purpose of, or one of the main purposes of which is to secure that an amount included in B's profit share
    - Is charged to corporation tax rather than income tax, or
    - Is otherwise subject to the provisions of the Corporation Tax Acts rather than the provisions of the Income Tax Acts, or
- Any of the following enjoyment conditions are met, in relation to B's profit share or part of B's profit share. S850C(21) requires A to mean A and any person connected to A other than B, and in all cases considering the whole or part of B's profit share.

    - Some or all of B's profit share is in fact so dealt with by any person as to be calculated at some time to enure for the benefit of A, whether in the form of income or not

- The receipt or accrual of B's share of the profits operates to increase the value of assets held by or for the benefit of A
- A receives or is entitled to receive at any time any benefit provided out of B's profit share
- A may become entitled to the beneficial enjoyment of B's profit share by the exercise of one or more powers of any person, or
- A is able to control (directly or indirectly) the application of B's profit share.

5.3.7 Anti-avoidance – A is not a partner in the firm

In order to prevent avoidance in the run up to the implementation of these provisions, new s 850D applies the same rules where A is not a partner in the firm, but performs services personally for the firm, and it is reasonable to suppose that A would have been a partner in the firm, had it not been for new s 850C. This is extended to include where A is a member of another partnership associated with the firm (i.e. it is a member of the first firm).

Where this condition is met, A is treated as a member of the first firm and the above provisions are applied in the same way.

5.3.8 Payments out of B's excess profit share

Once the excess profits have been allocated to A, any payments by B out of the profits now taxed on A are ignored for tax purposes. Accordingly new s850E states that for income tax purposes, the payment

- Is not to be income of the recipient
- Is not to be taken into account in calculating the profits of B, nor is to be allowed as a deduction form those profits, and
- Is not to be regarded as a distribution.

This applies when B makes a payment pursuant to an arrangement which is not put in place to secure a tax advantage for any person.

The excess profit conditions commence on 5 December 2013, but in relation to periods of account commencing on or after 6 April 2014. Where a period of account spans this date, it is to be treated as two separate periods for the purposes of s850C and 850D.

5.4 Losses in mixed partnerships

The loss restrictions on partners in Chapter 3 of Part 4 of ITA 2007 are further extended to exclude relief for losses in some mixed partnerships. New s 116A is inserted into ITA 2007 as follows:

The restriction is triggered by A making a loss in a trade carried on through a partnership, where A's loss arises directly or indirectly in consequence of or in connection with relevant tax avoidance arrangements. Here, relevant tax avoidance arrangements are arrangements to which A is a party, and the main purpose or one of the main purposes is to secure that losses of a trade are allocated or otherwise arise in whole or in part to A, rather than a person who is not an individual, with a view to A obtaining relevant loss relief. The change applies similarly to losses arising in property businesses (new s127C ITA 2007).

The restriction applies to losses made in 2014-15 and subsequent years, but periods of account spanning 6 April 2014 are to be split into two separate accounting periods for this purpose.

5.5 Disposals of assets and income streams through partnerships

Part 4 of Schedule 17 makes changes to the tax avoidance rules in ITA 2007 Part 13, inserting an additional Chapter 5AA, comprising new sections 809AAZA and 809AAZB. This brings into charge to income tax an income stream transferred from one partner (R) to another partner (S) who are either partners in the same firm or in associated firms. The premise is that the income stream is transferred by a change in ownership of the partnership with a main purpose test of tax advantage. Accordingly R remains taxable on the income.

The provision does not apply when R and S are married or civil partners and living together, nor to siblings, ancestors or lineal descendants.

Similar provisions are introduced for corporation tax in new Chapter 1A of Part 16 CTA 2010, comprising new ss 757A and 757B.

Finally, for both income and corporation tax, disposals via a partnership which would otherwise be taxed as income on the disposer if the asset was disposed of directly will be taxed as income if there was a tax avoidance purpose associated with one or more steps of the disposal. New ss 809DZA and 809DZB deal with the changes to ITTOIA 2005, while new ss 779A and 779B deal with the changes to CTA 2010.

6. FOLLOWER AND ACCELERATED PAYMENT NOTICES

The legislation for follower notices and accelerated payment is in Part 4 of the Act, running through ss 199 to 233 and Schedules 30 to 33 inclusive.

6.1 "Follower notices"

6.1.1 Definitions

Chapter 1 of Part 4 sets out various definitions. The key one to note is the taxes to which the new rules apply. They are (s 200):

- Income tax
- Capital gains tax
- Corporation tax, including amounts chargeable or treated as if they were corporation tax
- Inheritance tax
- Stamp duty land tax, and
- Annual tax on enveloped dwellings.

Tax advantage is also defined, and includes, in addition to the obvious, deferral of payment of tax, advancement of repayment of tax and avoidance of an obligation to deduct or account for tax. Tax arrangements are arrangements whose main purpose is to secure a tax advantage.

There are also definitions of a tax enquiry, and "return", which includes an IHT account. "Tax appeal" is also defined.

6.1.2 Follower notice – conditions

A follower notice may be given to a person P if conditions A to D are met.

- Condition A – a tax enquiry is in progress into a return or claim made by P in relation to a relevant tax, or P has an open tax appeal in relation to a relevant tax.
- Condition B – the claim or appeal is made on the basis that a particular tax advantage (the asserted advantage) results from particular arrangements (the chosen arrangements).
- Condition C – HMRC is of the opinion that there is a judicial ruling which is relevant to the chosen arrangements
- Condition D – no previous follower notice has been given to P (and not withdrawn) in relation to the same tax advantage, tax arrangements, judicial ruling and tax period.

A follower notice may not be given after the end of 12 months after the later of:

- The judicial ruling in Condition C, and
- The day the return was received by HMRC or the tax appeal was made.

6.1.3 Judicial ruling and relevance

Section 205 specifies when a Judicial ruling (a ruling by the court or tribunal) is relevant to the chosen arrangements. It is relevant if

a) It relates to tax arrangements,
b) The principles laid down or the reasoning given in the ruling would if applied to the chosen arrangements deny all or part of the asserted advantage, and
c) It is a final ruling.

A ruling is final if it is a ruling of the Supreme Court or a decision by a court or tribunal where no appeal may be made, or where permission for appeal is needed, the time period allowed has expired (either for permission or appeal) or any appeal made has been abandoned or otherwise disposed of before being addressed by the court. Rulings are treated as made when the relevant condition in the foregoing is first satisfied.

There are additional provisions where an out of time appeal is permitted, largely extending the period during which a follower notice may be issued in a case where the time limit above has already expired.

6.1.4 Content of follower notice

The follower notice must identify the judicial ruling on which it is based, and explain why HMRC believe that it is relevant to the taxpayer's chosen arrangements, and explain the next steps for the taxpayer.

6.1.5 Representations

P has 90 days in which to make representations about a follower notice. These are made in writing to HMRC, and can be made on the grounds that:

- Any of conditions A, B or D are not met
- The judicial ruling specified is not relevant to the chosen arrangements, or
- The notice was not given within the specified period.

On receipt of representations, HMRC must consider them and either confirm the follower notice (as is, or with amendment) or withdraw the notice, and notify P accordingly.

6.1.6 Action following confirmed follower notice

Section 208 specifies the corrective action to be taken following receipt of a follower notice. S 208 also prescribes a penalty if this action is not taken within 90 days (if no representations were made) or the later of the 90 day limit and 30 days after HMRC confirmed the notice following representations.

- First - P must amend a return or claim to counteract the denied advantage, or if under appeal, take all necessary steps to reach agreement with HMRC to relinquish (in writing) the denied advantage. S 208(9) waives the normal time limits for amending returns or claims.
- Second – P notifies HMRC that he has taken the first step, and of the denied advantage the additional amount of tax due by reason of taking step 1.

6.1.7 Penalties

The penalty for failing to take corrective action within the specified time is 50% of the denied advantage (or that part not corrected) (s 209). The penalty may be reduced to a minimum of 10% for co-operation (which is defined by s 210). Once assessed the penalty is due for payment within 30 days. Section 212 provides for a maximum amount of aggregate penalties where the taxpayer is also liable to penalties for inaccuracy (Sch 24 FA 2007), failure to notify (Sch 41 FA 2008) or failure to submit returns (Sch 55 FA 2009)in respect of the same tax period. In all cases the maximum aggregate penalty is a minimum of 100%, and up to 200%.

Appeals against the issue of a penalty notice, or the amount of penalty must be made within 30 days.

The value of the denied advantage for the purposes of a penalty under s 208 is set out in Schedule 30.

- The normal rule calculates it at the additional tax payable as a result of the denied advantage, ignoring group relief and relief under s 458 CTA 2010 (loans to participators).
- In the case of the unused portion of losses, 10% of the loss (treating losses which are group relieved as used, and therefore valued according to the normal rule) unless there is no reasonable prospect of it being used by P or anyone) in which case it is valued at nil.
- Where tax is deferred as a result of the denied advantage, the value is 25% of the amount of the deferred tax for each year of deferral (using pro rata for part years) or 100% of the tax if less.

6.1.8 Follower notices and partnerships

The legislation translates fairly logically into the partnership arena, with references to return being amended to read partnership return, and the tax advantage being available to any partner (Sch 31 para 3). Notices are served on the representative partner or his successor. A penalty assessed on a partnership is based on the amendments made to the partnership statement, and is calculated at 20% of the denied advantage – but this is the amount by which the partnership statement would be amended and therefore the income amount, not the tax amount. (Sch 31 para 4). It is shared out between the partners in accordance with their profit sharing arrangements in the relevant tax period. (Sch 31 para 5). Schedule 30 does not apply to partnerships.

6.1.9 Commencement and transition

In the case of judicial rulings made before Royal Assent, the time limit for the issue of a notice is revised to 24 months after Royal Assent (17 July), or 12 months after the receipt of the return or date of appeal if later.

6.2 Accelerated payment

6.2.1 Accelerated payment notice – conditions

HMRC may give an accelerated payment notice to a person P if the following conditions are met:

- Condition A – that a tax enquiry is in progress into a return or claim by P, or P has an open appeal in relation to a relevant tax
- Condition B – the claim or appeal are on the basis that a particular tax advantage (the asserted advantage) results from particular arrangements (the chosen arrangements)
- Condition C – one or more of the following are met:
    - HMRC has given P a follower notice in relation to the same tax advantage and arrangements
    - The chosen arrangements are DOTA arrangements (notifiable arrangements)
    - Arrangements subject to a counteraction notice under the GAAR, with which two of the GAAR panel have concurred.

6.2.2 Representations about a notice

Section 222 provides for P to make representations about a notice within 90 days either that any of conditions A, B, or C is not met, or disputing the amount specified in the notice (see below).

HMRC must consider the representations and then either confirm or withdraw the notice, and confirm or amend the amount, and notify P accordingly.

6.2.3 Accelerated payment notice –effect while enquiry is in progress

The notice must specify the grounds on which it is issued (relating to condition C), the payment to be made and explain what happens next.(s 200) The payment is to be determined by a designated HMRC officer, or is as stated in the GAAR counteraction notice.

P must then make the payment demanded within 90 days if no representations have been made, or by the later of 90 days and 30 days from being notified of the outcome of HMRC's consideration of the representations (s 223). The payments are to be treated as payments on account of the understated tax. If the tax is IHT due by instalments, the original due dates for the instalment payments apply to the accelerated payment.

6.2.4 Accelerated payment notice – effect when pending an appeal

The notice must state under which part of Condition C it is issued, the disputed amount of tax and what happens next. (s 221)

Section 224 then operates to prevent tax payments being postponed pending an initial appeal where an accelerated payment notice has been issued by amending the various powers to do so in all of the relevant taxes. Section 225 also enables HMRC to request the court for permission not to repay tax pending further appeals in order to protect revenue. This will apply where an accelerated payment notice has been issued.

There is no requirement, therefore for P to pay the disputed tax, as in the case of an open appeal, these two provisions ensure that the tax remains due on its original due date, and no repayment would be made, by virtue of the two amendments above.

6.2.5 Penalty for failure to pay accelerated payment

If P has received an accelerated payment notice during the course of an enquiry and has not paid the accelerated payment at the end of the time allowed, a penalty of 5% is due (s 226). Further penalties of 5% will apply when the tax is 5 months late and 11 months late. The rights of appeal in Sch 56 FA 2009 in relation to penalties for late payment of tax are imported by s 226(7).

6.2.6 Withdrawal of an accelerated payment notice

Section 227 sets out the requirements to withdraw or modify an accelerated payment notice. If issued in relation to a follower notice which is subsequently withdrawn or amended by reason of out of time appeal allowed, the accelerated payment notice is also withdrawn or amended accordingly. Where the other conditions for the notice to be issued change, again the notice is withdrawn. Once withdrawn, any tax and penalties due under it which have been paid must be repaid.

6.2.7 Impact on partnerships

Accelerated payment notices cannot be issued to partnerships, but instead a “partner payment notice” will be issued to the relevant partners, and will require the payment by each of them as expressed in their own individual notices. Penalties apply as to individual notices, and the remaining legislation applies, amended where necessary.

6.3 Modifications

Chapter 4 of Part 4 modifies both the follower notice and accelerated payment notice legislation in the case of both SDLT and ATED, where there may be joint owners of a property, or a partnership owning a property for the purposes of SDLT or ATED. S 230 makes joint (including partners) owners of land jointly and severally liable for any accelerated payment, and s 231 does the same for ATED.

7. PROMOTERS OF TAX AVOIDANCE SCHEMES

Part 5 of the Act (running from s 234 to s 283 plus Schs 34 to 36) deals with promoters of tax avoidance schemes, setting out a system of tight control and monitoring of certain promoters, and giving HMRC power to publicise that certain promoters are monitored by HMRC. There are hefty penalties associated with this legislation, which is covered in outline here.

7.1 Conduct notices

An officer of HMRC has a duty to issue a conduct notice to a promoter of tax avoidance schemes if during the last 3 years the promoter has met the threshold conditions in Sch 34 which still a promoter. The notice is given if the officer believes that requiring the pro9motr to meet the proposed conditions would be regarded as significant. The conduct notice will specify certain conduct required of the promoter, and a duration, which is a maximum of two years.

7.1.1 Threshold conditions

Meeting any of these can give rise to a conduct notice, but meeting conditions 1, 2, 3, 5 or 6 are regarded as sufficient reason for a conduct notice on their own.

1. Deliberate tax defaulter information published
2. Named in a report on a breach of the Banking Code of Practice
3. Dishonest conduct notice given to tax agent
4. Failure to comply with the requirements of Part 7 FA 2004 (notifiable proposals and arrangements, details of clients etc) even where there was reasonable excuse.
5. Convicted of certain criminal offences
6. In receipt of a notice under GAAR which is approved by at least 2 members of the GAAR panel
7. Found guilty of misconduct by a professional body
8. Found guilty of misconduct by a regulatory authority
9. Fails to comply with HMRC's information powers in para 1, 2, 5 and 5A of Sch 36 FA 2008
10. Imposes restrictive contractual terms regarding disclosure of arrangements to HMRC by a client or tax adviser, or requirement to contribute to a fighting fund, or to obtain P's consent before reaching an agreement with HMRC about a scheme promoted by P
11. Continues to promote arrangements after a stop notice has been issued in relation to them (power to do so is in para 12 of Sch 34 – explained below)

7.1.2 Stop notice

A stop notice may be issued to a promoter P by an authorised HMRC officer if a follower notice has been issued to a person in relation to arrangements promoted by P, and 90 days has expired during which the notice has not been withdrawn, and HMRC has considered any representations made and not withdrawn the notice.

7.1.3 Content of a conduct notice

The conduct notice will specify conditions that P must meet. These must be reasonable to impose for the following purposes:

a) to ensure that the recipient provides adequate information to its clients about relevant proposals, and relevant arrangements, in relation to which the recipient is a promoter;
b) to ensure that the recipient provides adequate information about relevant proposals in relation to which it is a promoter to persons who are intermediaries in relation to those proposals;
c) to ensure that the recipient does not fail to comply with any duty under a specified disclosure provision;
d) to ensure that the recipient does not discourage others from complying with any obligation to disclose to HMRC information of a description specified in the notice;
e) to ensure that the recipient does not enter into an agreement with another person (“C”) which relates to a relevant proposal or relevant arrangements in relation to which the recipient is a promoter, on terms which—
    (i) impose a contractual obligation on C which falls within paragraph 11(2) or (3) of Schedule 34 (contractual terms restricting disclosure), or
    (ii) impose on C obligations within both paragraph 11(4) and (5) of that Schedule (contractual terms requiring contribution to fighting funds and restricting settlement of proceedings);
f) to ensure that the recipient does not promote relevant proposals or relevant arrangements which rely on, or involve a proposal to rely on, one or more contrived or abnormal steps to produce a tax advantage;
g) to ensure that the recipient does not fail to comply with any stop notice which has effect under paragraph 12 of Schedule 34.

Adequate information about proposals or arrangements include:

a) ensuring the adequacy of the description of the arrangements or proposed arrangements;
b) ensuring that the information includes an adequate assessment of the risk that the arrangements or proposed arrangements will fail;
c) ensuring that the information does not falsely state, and is not likely to create a false impression, that HMRC have (formally or informally) considered, approved or expressed a particular opinion in relation to the proposal or arrangements.

7.2 Monitoring notices

Where a responsible officer determines that P has not complied with the conduct notice, he must apply to the tribunal for approval of a monitoring notice in relation to P, giving notice also to P. The tribunal may approve the notice if they consider the issue justified, and that P has had a reasonable opportunity to make representations. The tribunal may, however, take into account whether the condition in the conduct notice was reasonable to include, and if not may ignore the breach for this purpose.

Once a monitoring notice has been issued, P is known as a "monitored promoter".

A person subject to a monitoring notice may apply to have it withdrawn after 12 months of it being in force.

7.3 Monitored promoters

HMRC may publicise the fact that a promoter is a monitored promoter, and the promoter must inform all clients and intermediaries that they are monitored.

HMRC must allocate a reference number to the promoter, and this must be quoted on any returns submitted using proposals or arrangements that the promoter has promoted. The promoter also has a range of information that they must notify to HMRC, including details of firm approaches made, schemes implemented and proposals drawn up.

7.4 Penalties

The penalty provisions are set out in Sch 35, and the following table gives a flavour of the penalties for failure to comply with the new legislation. It is not comprehensive, and for example, daily penalties for failure to comply also apply – at £10,000 per day when the main penalty is £1m.

Provision	*Maximum penalty £*
Section 249(1) (duty to notify clients of monitoring notice)	5,000
Section 249(3) (duty to publicise monitoring notice)	1,000,000
Section 249(10) (duty to include information on correspondence etc)	1,000,000
Section 251 (duty of promoter to notify clients and intermediaries of reference number)	5,000
Section 252 (duty of those notified to notify others of promoter's number)	5,000
Section 253 (duty to notify HMRC of reference number)	the relevant amount
Section 255 (duty to provide information or produce document)	1,000,000
Section 257 (ongoing duty to provide information or produce document)	1,000,000
Section 258 (duty of person dealing with non-resident promoter)	1,000,000

Provision	*Maximum penalty £*
Section 259 (monitored promoter: duty to provide information about clients)	5,000
Section 260 (intermediaries: duty to provide information about clients)	5,000

The relevant amount is £5,000, but if the person has failed to comply with s 253 on a single occasion in the last 36 months it is £7,500, and if there have been more failures in the last 36 months, the penalty is £10,000.

8. TAX ADMINISTRATION

8.1 Information powers in relation to DOTAS

Finance Act 2004 is amended by the insertion of s 310A allowing HMRC to request further information in relation to notifiable proposals or arrangements. The notice will be used where some information has been provided but HMRC considers that there is more information which has not been provided. The notice can specify what information is required and also require documents in relation to the proposal or arrangements. The normal time limit will be 10 working days. (s 284)

8.2 Scottish rate of income tax

Schedule 38 makes the necessary changes to ITA 2007 to introduce the Scottish basic, higher and additional rates of tax. These are calculated by deducting 10% from each of the declared rates for England and Wales, and then adding the Scottish rate (which will be a single rate). (New s 11A ITA 2007).

The Scottish rates are only charged on non-savings income.

9. ADDITIONAL ARTICLES

9.1 Termination payment

Summary - The FTT found that a payment had been made to an employee in connection with the termination of his employment.

Mr Moorthy had been made redundant and had received £200,000 under a compromise agreement. He contended that this amount was not taxable as it had been paid to settle a discrimination claim, to compensate him for not being selected for a post and to protect his employer's reputation.

Decision:

The FTT observed that ITEPA 2003 s 401, which brings into charge a payment 'directly or indirectly in consideration or in consequence of, or otherwise in connection with the termination of a person's employment' is widely drawn.

The FTT found that the alleged discrimination, unfair dismissal and 'injury to feelings' were all connected to the redundancy, which had come as a 'shock' to Mr Moorthy. He confirmed that he had not suffered from any discrimination before the risk of redundancy had been mentioned to him and that he had been treated as a valued employee until then. The FTT concluded that the payment fell within the scope of s 401.

Comments - Mr Moorthy failed as he was unable to show that any of the issues he highlighted had existed prior to his redundancy. This was sufficient to establish the link with the redundancy required by s 401.

Krishna Moorthy v HMRC ([2014] UKFTT 834

9.2 Artificial transactions

Summary – The Tribunal found that the Ramsay principle applied in a tax avoidance scheme and accordingly the taxpayer’s appeal was dismissed

In his 2005/06 tax return, the taxpayer claimed a deduction of £303,123 in respect of two payments made in relation to loan notes as part of a marketed tax avoidance scheme. He said they were manufactured overseas dividends under TA 1988, Sch 23A para 4(1) and were therefore annual payments under s 349(1).

HMRC did not accept the claim and amended his return bringing the sum into charge.

Decision:

Dismissing the taxpayer's appeal, the First-tier Tribunal accepted HMRC's contention that the Ramsay principle applied and, as a result, the payments did not fall within s 349(1). The taxpayer appealed.

The Upper Tribunal judge said it was clear that the overall effect of the transactions had no commercial purpose, and had been carried out solely to avoid tax. He said: “All the transactions were organised in advance, and consisted of movements of funds in a circle, with the payments being recorded in writing.” The transactions were self-cancelling; and no one was better or worse off. The payments, the loan notes and the transfers were all artificial and their only purpose was to enable the taxpayer to claim that the requirements of the legislative provisions had been met.

The taxpayer's appeal was dismissed.

Comments - According to an HMRC news release issued after the appeal, 305 taxpayers took part in this NT Advisors scheme and the tribunal's ruling “is expected to protect £156m in tax”. HMRC said they “will now pursue the other users of the scheme to make sure all the taxes that are due are paid”.

Chappell v CRC, Upper Tribunal

9.3 Attribution of employee fraud

Summary – The Tribunal found that despite the fraud perpetrated by the employee the PAYE liability was still due and allowed an appeal by the director that the two cars were pool cars

In 2000, Isocom discovered that an employee, HI, had fraudulently taken money for himself which was intended for HMRC. He was convicted of theft in July 2001.

In 2004, during an employer compliance review, HMRC concluded that forms P35 for 1997/98, 1998/99 and 1999/2000 understated the tax and National Insurance due. HMRC issued determinations to recover the underpaid sums. The company appealed saying that HI had forged the P35s and they were not the ones signed by its managing director, B.

The company's adviser agreed there had been a loss of tax, but it was caused by the fraudulent conduct of an employee who had sought to defraud the company. The behaviour could not therefore be attributed to the company.

Further, the company told HMRC about the fraud in 2000, but the Revenue failed to address the matter until 2004, so the assessments were out of time.

Decision:

The First-tier Tribunal accepted that the company had not perpetrated the fraud, but this did not stop the PAYE liability being due. The judge referred to Bilta (UK) Ltd (in liquidation) and others v Nazir and others [2013] STC 2298, saying this supported the contention that "attribution of fraud to a company is appropriate in circumstances where a company would suffer loss by compensating HMRC for a loss of tax which was properly due". He decided that, in that instance, HI's actions should be "properly attributed" to the company. The element of fraud having been established, the extended time limit in respect of PAYE and National Insurance applied.

The taxpayer's appeal was dismissed.

At the same time, the tribunal heard an appeal by B in respect of his personal tax affairs. HMRC had raised discovery assessments in relation to car benefit on the basis that B had not declared the use of two company cars. B argued that the vehicles were pool cars. The judge accepted the taxpayer's evidence that they were pool vehicles and allowed the appeal.

Comments – It is unusual to get a case before the Tribunal involving a fraud by an employee but this case involved the potential PAYE liability arising from the actions of the employee that had caused an underpayment. The liability remained with the company. In a separate appeal the director was successful in the argument that two cars were actually pool cars.

Isocom Ltd and G H Tahmosybayat v HMRC TC3696

9.4 Reasonable excuse

Summary – The Tribunal found that the taxpayer who frequently contacted HMRC regarding the filing of a form P35 had a reasonable excuse throughout the relevant period

The taxpayer appealed against the issue of penalty notices for the late submission of a form P35 for 2007/08. The filing date was 19 May 2008 and the taxpayer said that its attempt to file on that date failed because the government gateway "crashed". Although there was no evidence to corroborate this, the next day it asked HMRC for advice and was told to submit a paper form P35. The taxpayer did this and heard nothing more until it received a penalty notice in September 2008. The business again contacted HMRC who sent another P35, but this was for 2005/06. On 4 February 2009, the taxpayer asked HMRC to send a form for the correct year. There was no evidence of the date of receipt of that form, but a paper P35 for 2007/08 was finally received by HMRC on 22 June 2009.

The taxpayer did not argue that the penalties were unfair, but said it had acted in good faith.

Decision:

The tribunal agreed that the taxpayer had exercised reasonable foresight and due diligence, but the default occurred despite this. It therefore had a reasonable excuse and this applied through the whole period of default. The taxpayer's appeal against the penalty was upheld.

Comments – This is another case demonstrating that actions taken or not taken by HMRC can compound a failure but the importance of adequate records to prove a position is also demonstrated and consequently a reasonable excuse was held to be applicable

A & B Fencing Ltd v HMRC TC3717

9.5 Taxpayer strike out

Summary – The Tribunal found that the delay in dealing with the relevant returns meant that the claims could not be made as they were out of time

The taxpayer was a UK resident, but had not completed tax returns for 2005/06 or 2006/07 (or in fact up to 2009/10). This situation persisted until January 2012 when all outstanding returns were submitted, by which time HMRC had issued 14 statements of account, including penalties for non-submission of the returns. The 2005/06 and 2006/07 returns showed tax repayments totalling £49,000, which the taxpayer sought to have set against liabilities for subsequent years.

TMA 1970, Sch 1AB imposes a four-year limit for tax reclaims, so the deadline for the above years was 5 April 2010 and 5 April 2011. TMA 1970, Sch 1AB para 3A(1) allows the time limit to be extended if a determination of liability was made under TMA 1970, s 28C and the taxpayer believes that the tax is not due. The determination refers to those made by HMRC under TMA 1970, s 8 or s 8A.

HMRC argued that the appeal should be struck out because there was no legal basis for accepting the self-assessment tax returns outside the normal time limit, particularly because no determination of liability had been made.

The taxpayer's advisers argued that, although there was no technical argument in the taxpayer's favour, she deserved to have the returns accepted and it would be a breach of natural justice not to. Ms Lawford had been unable to obtain information about the value of her US share options and decided that it was better not to submit returns rather than to submit incorrect ones. She was unfamiliar with the complex nature of the tax rules relating to the options and now wished to claim credit for the overpaid tax against the liabilities for subsequent years.

Decision:

The tribunal accepted that the taxpayer might feel aggrieved that, partly because HMRC had not issued a determination and partly because the equitable liability concession had been withdrawn, she would not be able to reclaim tax. However, it had no jurisdiction to interfere although, even if it had, it would have expected to see that the taxpayer had acted reasonably with regard to her affairs and it was not apparent that she had.

The tribunal concluded that there was little merit in the application and agreed that the appeal should be struck out under the Tribunal Procedure (First-tier Tribunal)(Tax Chamber) Rules 2009, rule 8(2).

Comments – This case demonstrates perfectly that there are time limits for a very good reason to ensure that a taxpayer's affairs are dealt with on a timeous basis. The normal time limits changed a while ago from 6 years to 4 years but these matters applied long before that. There had been a significant number of statements of account which would highlight to the taxpayer the need for action. It was surprising the delay bearing in mind the amount of the overpayment. Taxpayers always need to be on top of their tax affairs particularly if they want repayments.

Janet Lawford v HMRC TC3707

9.6 Late withdrawal of case by HMRC

Summary - The UT found that HMRC had not been unreasonable in not withdrawing at an earlier stage.

The issue was whether HMRC had unreasonably prolonged matters once they were in the tribunal. The FTT had concluded that, having regard to the basis on which the application had been made and to the 'disproportionate enquiry' that would be needed to resolve the matter, it was not prepared to exercise its discretion in Mr Tarafdar's favour.

Decision:

The UT found that the FTT had been wrong to regard the necessary enquiry as encompassing the resolution of the best judgment issue (which was the substantive issue), irrespective of the way in which the application had been put. The UT therefore considered whether the FTT's decision should be set aside.

HMRC had decided to withdraw because it was unable to obtain evidence from the officer involved in the case, as he had retired. It was accepted that HMRC had known that it would not be able to obtain this evidence long before the FTT hearing. However, HMRC could not have been expected to know that the honesty or genuineness of the officer would be called into question. It could not therefore have anticipated that the officer would be called to give oral evidence.

The UT therefore found that HMRC had not been unreasonable in not withdrawing at an earlier stage and concluded that the FTT's decision should not be set aside.

Comments - The UT delineated the tax tribunals' jurisdiction on costs. Although the case turned on the best judgment exercised by an HMRC officer, the UT could make a decision on costs without deciding the underlying substantive issue.

Tarafdar v HMRC ([2014] UKUT 0362

9.7 Could reasons for s 80 VAT claim be amended?

Summary - The FTT held that Vodafone was entitled to amend the reasons for a claim after the expiration of the four-year time limit.

Vodafone had made a repayment claim for £4.1m (under VATA 1994 s 80) and HMRC accepted that Vodafone had overpaid more than that amount. Vodafone therefore contended that it was irrelevant that the basis of its voluntary disclosure (made to recover the various overpayments) was not the basis on which HMRC accepted that there was an overpayment. Vodafone's position was that a 'claim' for the purpose of s 80 is not restricted to the reasons advanced for making the claim and that once an overpayment was agreed (for whatever reason), the claim must be paid. HMRC argued that to allow the claim to proceed would offend legal certainty, as it would be open to any taxpayer to substitute one claim for another provided that the new claim was for the same (or a lower) quantum.

Decision:

The FTT rejected this assertion, observing that HMRC would have the certainty of knowing that the taxpayer was claiming a stated amount within the time limit. Any other interpretation would give HMRC the benefit of a windfall. The FTT also referred to BUPA Purchasing (No. 2) [2008] STC 101 as authority for the proposition that the underlying reasons for an assessment may change after the expiry of the time limit to make a new assessment. This case was the 'mirror image' of BUPA, as it related to a claim for repayment and Vodafone should therefore succeed under UK law. The FTT did, however, admit that parliament cannot have intended to give taxpayers the possibility to make speculative claims within the time limit, as this would effectively allow taxpayers to avoid the time limit and these would therefore not be s 80 claims. Finally, the FTT noted that the EU principle of equivalence did not assist Vodafone, as HMRC would not fundamentally alter the reasons for an assessment, such that the underlying payment arose out of an entirely different factual matter, at the point when they are out of time to raise a new assessment. In this case, the underpayments arose from entirely different facts and circumstances to the claimed underpayment which originally led to the making of the claim.

Comments - The decision seems primarily based on the notion that HMRC's obligation to give reasons for assessments is governed by the same principles as the obligations of taxpayers to give reasons for repayment claims.

Vodafone Group Services v HMRC TC3822

9.8 HMRC witnesses

Summary - The FTT dismissed an application for costs. The appellant had appealed against an assessment which HMRC had withdrawn by letter to the FTT.

Mr Letts made an application for costs, pursuant to rule 10 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules, SI 2009/273. The FTT could only make such an order against HMRC if it had acted 'unreasonably in … defending or conducting the proceedings'. Mr Letts' contention was that HMRC had acted unreasonably in refusing his request that HMRC officers be called as witnesses, forcing Mr Letts to apply for a witness summons at the cost of over £5,000.

Decision:

However, the FTT found that HMRC's refusal had not been unreasonable. The issue had not been whether HMRC had been careless but whether the appellant had been careless (under TMA 1970 s 29(4)).

Comments - The case confirms — perhaps contrary to what some taxpayers may think — that HMRC does not have to produce witnesses.

Peter Letts v HMRC TC3830

9.9 Transfer of assets to Gibraltar avoidance

Summary - The FTT partially allowed the taxpayers' appeals against discovery assessments raised on the basis of tax avoidance.

Stan James, a UK resident company owned by the Fisher family (Anne, Stephen and Peter), carried on a telebetting business. Like many other similar businesses, it had moved its operation to Gibraltar by selling its business to a Gibraltan incorporated company also owned by the Fisher family.

Decision:

The first issue turned on the interpretation of the anti-avoidance legislation (ICTA 1988 s 739) on the transfer of assets abroad and, in particular, on whether the 'motive defence' applied. The Fishers argued that the Gibraltan company had been set up not to avoid betting duty, but to save their business, as they would otherwise have lost business to the competition which was moving to Gibraltar.

The FTT found that betting duty avoidance was the main purpose of the transfer. It was 'inconceivable that the transfer would have gone ahead were it not for the betting duty being lower in Gibraltar'. The Fishers' argument about survival was therefore in the context of betting avoidance being the means for survival.

The second issue was the application of the EU principle of freedom of establishment. The FTT found that the principle did not apply between the UK and Gibraltar, as the UK is responsible for Gibraltar's external relations. Relations between the UK and Gibraltar are therefore not external and a UK national cannot avail himself of this principle when moving to Gibraltar. The position was different for one of the shareholders, Anne Fisher, who was Irish; she was potentially being dissuaded from establishing in the UK (for the purpose of the argument). The FTT found that the UK provisions restricted her freedom of establishment in a way that was not proportionate to any legitimate justification of fighting tax avoidance.

The last issue was the validity of the discovery assessments raised by HMRC under TMA 1970 s 29(5)(b). Should the relevant HMRC officer have been aware of an underpayment of tax at the time the enquiry window closed? The FTT found that the officer should have been aware (as a result of replies to enquiries) of the existence of accounts which would be relevant to establishing an insufficiency of tax.

The appeals were therefore allowed in relation to Stephen and Peter Fisher for the tax years 2005/06 and 2006/07. The appeals for the remaining years were dismissed in principle.

The appeals by Anne Fisher were allowed.

Comments - This is a very long and complex case running to some 172 pages. It contains some interesting discussions on the establishment of the purpose of a transaction where several taxpayers are involved; the application of the EU freedoms to relations between the UK and its territorial dependencies; and the establishment of a discovery prompted by the publication of a newspaper article.

Fisher v HMRC ([2014] UKFTT 804

9.10 Goodwill and termination payments

Summary - The FTT held that a payment made for goodwill was not deductible from a termination payment.

HMRC had disallowed the deduction of a sum paid for goodwill on the acquisition of a post office from a payment made by Post Office Ltd on the closure of that post office. The post office was compulsorily closed under Post Office Ltd's 'network reinvention progamme'. It was accepted that the payment was employment income, so that the first £30,000 was exempt from income tax (ITEPA 2003 s 403(1)).

Decision:

The FTT therefore observed that any set-off must be of an income nature. The only deductions allowable are set out in ITEPA 2003 s 336(1) and refer to expenses 'incurred wholly, exclusively and necessarily in the performance of the duties of employment'. However, the payment made by Mr Devaraj had been to the vendor (and not to Post Office Limited) for the trading connections of the business; this was therefore a capital transaction. Furthermore, the closure of the post office was a permanent cessation which gave rise to a disposal for CGT purposes, producing a capital loss available for carry forward. The taxpayer argued that the payment for goodwill had been of a revenue nature, but the FTT noted that this had been an afterthought. Goodwill could not in any event be amortised in the accounts of a sole trader (contrary to the position for companies).

Comments - This was an unusual case in that an office holder received a payment akin to a termination payment in circumstances where he had been a sole trader. This caused a dichotomy between the termination payment (subject to income tax) and the payment made on acquisition of the goodwill (subject to CGT).

Sabaratnam Devaraj v HMRC TC3834

9.11 <u>No control</u>

Summary – The tribunal concluded that the control element of the agency worker provisions was not satisfied and therefore the taxpayer's appeal was allowed.

The taxpayer, a security guard, supplied security guards to building construction sites. HMRC accepted that the workers were not employees of the taxpayer, but said they were agency workers (ITEPA 2003, s 44). The taxpayer should therefore have deducted PAYE and National Insurance on their earnings. The taxpayer appealed, saying the workers should be treated as self-employed.

Decision:

The First-tier Tribunal said that to satisfy s 44, the taxpayer would have to exercise control over the way the workers performed their duties.

The judge accepted the taxpayer's assertion that he was never on site with the workers and, because they were qualified security guards, they would have been working as appropriate. He therefore did not have control or right of control over them.

The tribunal concluded that the control element of the agency worker provisions was not satisfied.

The taxpayer's appeal was allowed.

Comments – We do not often see cases involving the agency worker provisions in Tribunal cases – in fact although employment v self-employment cases are not frequent they appear more often than cases involving agency workers. This case is a good demonstration of the conditions that apply in the rules and the need for them to apply for the responsibility for PAYE and NIC deduction to apply.

G Oziegbe v HMRC TC3733

9.12 Main object

Summary – The Court of Appeal has overturned the decisions of both the FTT and the UT on the capital allowances applicable to two merchant ships and remitted the case back to the FTT

The taxpayer, a finance leasing company, claimed capital allowances at the rate of 25% in respect of its purchase of two merchant ships.

HMRC refused the claim, saying the effect of CAA 2001, s 123 “ships and aircraft” was that the taxpayer was not entitled to the allowances. The First-tier Tribunal allowed the taxpayer's appeal. The Upper Tribunal confirmed that decision, holding that the only requirement of s 123(4) was that the taxpayer's main object of a relevant transaction was to obtain a writing-down allowance other than an allowance such as s 109 (writing-down allowance at 10%).

Decision:

Lord Justice Rimer in the Court of Appeal said in principle the taxpayer was entitled to the 25% writing-down allowances in respect of its purchase costs of the vessels. They were used for a qualifying purpose within the meaning of s 123(1). The question raised by s 123(4) was whether “the main object, or one of the main objects” of any of the transactions in question “was to obtain a writing-down allowance …” If it was, the claim to the allowance would fail because the ships would not have been used for a qualifying purpose and so would not satisfy s 123.

The First-tier Tribunal and the Upper Tribunal found in favour of the taxpayer on this point.

Lord Justice Rimer said that the tribunal had not, however, explained its reasoning. He said:

“Although the First-tier Tribunal was no doubt entitled to find that each transaction in the relevant series served a genuine commercial purpose, it does not follow that the obtaining of the capital allowances was incapable of also being a main object of the transactions, even if it was not the main object of the transactions. The First-tier Tribunal does not explain why it was not such a main object.”

He added: “Even if each of the transactions was entered into for a genuine commercial purpose, it may still be the case that a main object of structuring them in the way they were was to obtain the capital allowances” and the facts set out by the First-tier Tribunal “might be said to provide a factual basis for a finding that it was”.

He remitted the case to the First-tier Tribunal for a reconsideration of whether “it was not the main object, or one of the main objects, of the letting of the vessels on charter, or of any series of transactions which included such letting, to obtain the 25% writing-down allowance”.

As an aside, the judge was critical of the provision saying he did “not regard s 123(4) as a cleverly drafted piece of legislation. To make the availability of a capital allowance dependent on what is ultimately the subjective intention of a party to a transaction is a recipe for dispute and litigation, no better illustrated than by what has happened in this case, namely a seven-day hearing before the First-tier Tribunal, a four-day hearing before the Upper Tribunal and a day and half's hearing before this court.”

HMRC's appeal was allowed.

Comments – This case demonstrates the importance of how legislation is worded. The question raised by s 123(4) was whether “the main object, or one of the main objects” …… As Rimer LJ highlighted the words mean that there can be more than one main purpose and whilst there may be a single main purpose perceived by the taxpayer that is not necessarily the perception by HMRC or by the Courts as this shows. Clearly a finding of fact is necessary on the matter and accordingly the case has been remitted back to the FTT for a decision.

Lloyds TSB Equipment Leasing (No 1) v CRC, Court of Appeal

9.13 Ambiguous description

Summary – The Tribunal found that HMRC were entitled to raise a discovery assessment and the taxpayer's appeal was dismissed

The taxpayer bought a yacht which he hired to customers. In his tax return, he said he was in the yacht chartering and skippering business and claimed losses arising from capital allowances against his other income. He was unaware that ITA 2007, s 75 precluded such losses being used in this way unless he spent half his time carrying on the trade.

HMRC raised discovery assessments (TMA 1970, s 29) to recover the tax when they realised that the taxpayer did not meet the requirements of s 75.

The taxpayer appealed, saying the return contained sufficient information for HMRC to have realised the incorrect claim in time.

His description of his business as chartering and skippering made it clear that there were two separate activities. This should have led HMRC to note that one activity, chartering, involved the mainly passive letting out a yacht on a bareboat basis, and therefore could not have satisfied the conditions in s 75.

Decision:

The First-tier Tribunal disagreed that the description should automatically have indicated the business was bareboat chartering. It was not unreasonable for HMRC, from the business description, to have assumed that the taxpayer met the active involvement test. An inspector would have had to ask for more information to know there was an underpayment.

Furthermore, s 75 was “of fairly limited relevance”, used mainly in the context of hobby farming, and it was “unrealistic to assume that the average inspector should be assumed to have been aware of it”.

HMRC were entitled to raise a discovery assessment and the taxpayer's appeal was dismissed.

Comments – The burden of providing sufficient information on a tax return clearly falls on the taxpayer. This was spelt out in no uncertain terms in the decision in Langham v Veltema. Taxpayers may try to ascribe information and understanding to an inspector but as Auld LJ spelt out the details in a return need to be crystally clear to an inspector of taxes. The tribunal did not consider it to be clear and therefore decided against the taxpayer.

A Salmon v HMRC TC3789

9.14 IBAs and commercial buildings

Summary - The UT found that a laundry managed by a Health Board was a 'commercial building' for the purpose of the initial industrial buildings allowance (IBA).

David Thomson was a member of a syndicate which funded the construction and fitting out of a building procured by Lanarkshire Primary Care NHS Trust for use as a laundry. The building is located within an enterprise zone and the expenditure would qualify for a 100% IBA if the building was used as a 'commercial building' (CAA 2001 s 271). 'Commercial building' means, inter alia, a building which is used for the purpose of a trade, profession or vocation (s 281).

Decision:

The UT noted that there was no statutory definition of 'trade' and that most case law was concerned with whether a single transaction was in the nature of a trade, which was not directly relevant to the case. Certain observations could, however, be made from the case law; for instance, the absence of an intention to profit does not necessarily mean that there is no trade.

Consequently, a public body like Lanarkshire — which carries out functions for which no charge is made at the point of delivery — could carry on a trade.

The UT found that Lanarkshire provided laundry services, a commonly provided service of a commercial nature, in consideration for payment by two other Health Boards. The facts that the charges were calculated solely to cover Lanarkshire's costs, and that the laundry's sole customers were public bodies, did not alter the analysis. The building in which the laundry was operated was a commercial building.

Comments - The concept of trade remains as elusive as ever, particularly given that a transaction between public bodies without a view to profit can constitute a transaction in the nature of a trade.

HMRC v David Thomson ([2014] UKUT 0360

9.15 Unpaid share instalment as a loan to a participator? (Lecture P854 – 6.53 minutes)

G agreed to subscribe for shares in a close company (RKW Ltd) for just over £2,000,000, but the entire subscription price was payable by instalments over a four-year period. As it turned out, G did not pay the instalments.

HMRC argued that G was a participator in a close company and that he had incurred a debt to RKW Ltd for the purposes of what is now S455 CTA 2010 on entering into the agreement. The company was therefore assessed to tax under S455 CTA 2010.

RKW Ltd appealed against this assessment on the basis that amounts due in respect of the making of an investment by G could not constitute a debt for S455 CTA 2010 purposes and also that G was not a participator in the company at the time when he subscribed for the shares.

The First-Tier Tribunal decided that the agreement to pay for the shares did *not* constitute a debt for S455 CTA 2010 purposes. In the words of one of the judges:

‘On an objective analysis and in the context of the mischief at which S455 CTA 2010 is aimed, “debt” does not extend to circumstances where effectively G was an investor and owed the company nothing. The liability of G was a liability to honour an investment promise. This was a share subscription, not a share purchase. The subscription agreement refers to “fully issued”. Nothing in the terms relating to G’s investment referred to “fully paid and called up”. It was not a liability to repay monies borrowed or owed. It was not a debt within the context of S455 CTA 2010.’

The Tribunal went on to say that G was not an existing shareholder at the time when he subscribed for the shares in RKW Ltd and so could not be a participator, given that the legislation uses the present tense in S455(1) CTA 2010, viz: ‘a relevant person who *is* a participator’ (speaker’s emphasis)

The term does not therefore include a prospective participator.

They added that, taking into account the context and the terms of G’s subscription, the loan did not represent the sort of mischief at which S455 CTA 2010 is aimed, namely the preventing of shareholders extracting funds from a close company in an otherwise non-taxable form.

The company’s appeal was allowed.

This decision is useful in clarifying that unpaid share subscription monies do not constitute a loan to a participator.

Contributed by Robert Jamieson

9.16 Automatic relief for expense claims (Lecture P855 – 15.40 minutes)

In his most recent Budget, the Chancellor announced a number of measures aimed at simplifying the administration of benefits in kind and employee expenses. This followed on from the January 2014 report by the Office of Tax Simplification (OTS) of the review which they conducted into the tax regime for employee benefits and expenses.

With regard to these matters, there are four main changes which the Government plan to include in FA 2015:

(i) abolishing the threshold for the taxation of benefits in kind for employees who earn less than £8,500 per annum;

(ii) introducing a statutory exemption for trivial benefits;

(iii) introducing a system of voluntary payrolling for benefits in kind; and

(iv) replacing the present dispensation system with an exemption for paid and reimbursed expenses.

This note looks at the last of these areas following the publication on 18 June 2014 of a consultation document entitled ‘Employee Benefits And Expenses – Exemption For Paid Or Reimbursed Expenses’. The closing date for comments on this paper is 9 September 2014.

The existing system operates at two levels. Employers can apply to HMRC for a dispensation, allowing them to pay specified expenses to their staff without having to report these items to HMRC and, of course, without having to deduct income tax and NICs.

Unfortunately, HMRC do not make dispensations available to all employers, mainly because of their concern about the misuse of expense payments in connection with tax avoidance. Employees of a company without a dispensation arrangement are thus charged to tax on their expense claims which they then have to recover from HMRC after the end of the tax year.

This regime was condemned by the OTS in their report. The OTS recommendation was that it should be replaced with a straightforward exemption for qualifying expenses, allowing all employers to determine for themselves whether an expense payment is taxable or not. All employees of all companies would automatically receive tax relief on their legitimate expenses, subject only to checks being made by HMRC on the employer's records.

Interestingly, the Treasury seem to have accepted this recommendation in full – hence the consultation document. It includes the kinds of safeguards which the Treasury intend to impose in order to prevent the rules being abused. The main issues to be resolved by the consultation are:

(i) the types of record which employers must keep and the checks which they must carry out on employee expense claims;

(ii) measures against abuse such as salary sacrifice arrangements – this will probably be achieved through a targeted anti-abuse rule;

(iii) the need for improved HMRC guidance on the tax rules for expenses so that employers can be confident that they are applying the correct income tax and NIC treatment to the expenses which they pay to their staff;

(iv) the setting of 'scale rates' which employers pay to their employees instead of paying or reimbursing the actual amount of their expenses – this will be the case with, for example, subsistence expenses (HMRC are particularly concerned about one-man companies and the directors of small close companies because they suspect that, in practice, there is no real checking that the individual is incurring allowable expenses – hence the proposal that such companies should be prohibited from paying 'scale rate' expenses); and

(v) transitional arrangements – it has already been decided that all employers will have to adopt the new system, ie. there will not be an opt-in or an opt-out facility.

Contributed by Robert Jamieson

9.17 Lease v Hire Purchase (Lecture B853 – 16.37 minutes)

Hire purchase and leasing have very different tax implications and an incorrect decision as to which source of financing is used can be costly in lost tax relief and VAT reclaims.

Clients need to be persuaded to engage with you prior to making a decision perhaps by sending them a mailshot explaining the differences and how expensive the wrong choice can be.

Tax implications of hire purchasing

A hire purchase agreement is treated as the purchase of the asset on day 1 with a loan to pay for it. It is as supply of goods for VAT purposes so VAT is reclaimable in its first return after the HP agreement is signed, subject to normal blocking rules (e.g. cars not used 100% for business purposes).

There is no VAT on instalments as these are finance transactions. Capital allowances are available based on cash price of asset including the 100% annual investment allowance. HP interest is deductible when expensed as long as this is done in compliance with generally accepted accounting practice.

Tax implications of leasing

As long as UK GAAP is followed, the tax treatment follows the accounting treatment. Therefore if the lease is an operating lease, the rental expense is deductible subject to the 15% CO_2 restriction for cars.

If the lease is a finance lease, depreciation of the lease asset and interest on the lease liability is deductible (again subject to the 15% CO_2 restriction).

No capital allowances are available on leased assets unless it is a long-funding lease of plant and machinery subject to many conditions – this is most unlikely for typical clients.

For VAT purposes, a rental is a supply of a service – VAT is incurred for each lease payment made.
Reclaim of this input VAT is subject to the normal VAT reclaim rules. It is normal to get a tax invoice showing tax points for next 12 months –VAT is reclaimed as appropriate based on these tax points

Comparing the two financing methods

Strictly speaking, we need to use net present value techniques on the cash flows including the tax savings to compare different financing methods.

On a simpler level, 100% AIA availability may make HP more attractive at the moment without having to go into detailed calculations.

VAT flat rate scheme users need to be careful because no input VAT can be reclaimed on leases but a flat rate scheme user can recover input VAT on HP if the cash price of goods is at least £2,000 including VAT (except cars) so HP is much more tax efficient for this group.

Example

A small OMB client has the choice between leasing a new van under a finance lease or buying it using hire purchase. It could have borrowed from its bank at 12% per annum. Both contracts would be over four years and the van is expected to have a value of approximately £2,000 after four years.
The cash price of the van is £24,000 plus 20% VAT.
Rentals under the lease contract would be £554 plus 20% VAT per month with a rate implicit in the lease of 9% per annum (0.7191% per month). The present value of rentals is £22,582.

Instalments under the HP contract would be £603.76 per month (no VAT) with an APR of 10.48% (0.8340% per month). The client is likely to sell the van after 4 years under this option.

Explain the tax treatment differences between the lease and HP agreements and how we would compare the cost of each.

Tax differences

Leasing

The client would reclaim input VAT of £110.80 each month, unless registered under the flat rate scheme. The van would be capitalised at present value of rentals of £22,582 and depreciated over 4 years, giving an annual deduction of £5,645 representing the depreciation of the asset.

Interest on the lease liability would also be deductible – a spreadsheet would be needed to compute the monthly amounts, but they would decrease over the lease.

Hire purchase

The client would reclaim input VAT of £4,800 on day 1, even if registered under the FRS – clearly beneficial in this case.

100% AIA would be claimable on the cash price of £24,000. The depreciation would be disallowed but interest on the HP liability would be deductible – again a spreadsheet would be needed to compute the monthly amounts.

Least cost option

It is important that an accountant can do this cost comparison using a simple spreadsheet.

Lease - schedule cash flows by month including

- Rentals (net if VAT can be reclaimed, gross if not)
- Tax saving on the finance lease deductions (9 months after accounting period)
- VAT reclaimed (quarterly, annually, monthly depending on frequency of returns)

Discount each month's net cash flow using borrowing rate of 12%

Hire purchase – again schedule cash flows by month including

- Instalments
- VAT reclaimed on cash price (in month when reclaim would reduce VAT paid or be refunded)
- Tax saving on depreciation and HP interest (9 months after accounting period)
- Value of the asset at end of HP period (£2,000) as it could be sold by client at that time

Again, discount each month's net cash flow using 12%.

Then compare the NPV of cost of each.

Contributed by Malcolm Greenbaum

9.18 Fees paid to banks' advisers

Summary – The Court of Appeal found that Airtours was not entitled to recover input tax in respect of services provided by PwC

In 2002, the appellant company Airtours was suffering financial problems. Various institutions that had lent it money, Airtours and PwC entered into a tripartite agreement retaining PwC to carry out a review of the business, with the company responsible for PwC's fees, expenses and disbursements.

The company claimed the input tax on the costs in its VAT returns. HMRC refused the claim, so the company appealed.

Referring to CCE v Redrow Group [1999] STC 161, which concerned a similar arrangement, the First-tier Tribunal allowed the appeal. HMRC appealed, arguing that the agreement provided for PwC to supply services to the institutions, not the taxpayer.

The Upper Tribunal (Tax and Chancery Chamber) agreed with HMRC and allowed their appeal.

The company appealed.

Decision:

The hearing had been adjourned pending the Supreme Court decisions in CRC v Loyalty Management [2013] STC 784 and WHA Ltd and another v CRC [2013] STC 943. Both of these confirmed that the decision of the House of Lords in CCE v Redrow Group was correct, subject to a qualification of the House of Lords' reasoning.

The Court of Appeal said the contract between the taxpayer and PwC was important. It provided that the services of PwC would be supplied to the financial institutions, for their benefit rather than that of the taxpayer. Two of the Court of Appeal judges, Lord Justices Vos and Moore-Bick, ruled that the Upper Tribunal had been correct in deciding that the taxpayer's only role in the agreement was to pay PwC's costs. It gained nothing from the review.

The First-tier Tribunal had been wrong to consider Airtours' need for the report. The correct question was an objective one: to whom were the services supplied? The answer was to the financial institutions.

Lady Justice Gloster disagreed, saying there had been two supplies from PwC, one to the institutions and one to the taxpayer. On that basis, she found for the taxpayer but because she was in the minority, the taxpayer's appeal was dismissed.

Comments - Noting that this appeal was first heard by the First-tier Tribunal in 2009, Neil Warren, independent VAT consultant, said: “A key factor in this case was that the company's creditors made the initial contact with PwC, rather than Airtours, which was an early indication that services would be supplied to the creditors rather than the taxpayer. The decision illustrates that just because a business gets an invoice addressed to it from a supplier and pays the amount due, there are other issues to consider before input tax can be claimed, that is to make sure that the business is actually the one that received the goods or services in question.”

The decision will be relevant to any situation in which payment for a supply is not made by its direct recipient. This case confirms that the person paying for the supplies will only be able to recover input tax if the transaction documents clearly set out the nature of the services provided to that person. The court focused on the engagement letter which (in the main) provided for the services to be supplied to the banks.

Airtours Holidays Transport Ltd v CRC, Court of Appeal

9.19 <u>Supply of self-storage</u>

Summary - The UT allowed HMRC's appeal, finding that the taxpayer was not making exempt supplies of land.

Mr Finnamore provided self-storage facilities by supplying containers which were located on land he owned. The containers were moveable, although special lifting gear was required. The containers usually rested on the ground under their own weight.

Customers could either use containers on the site or rent a container only and take it away. The site was fenced and guarded by a security team.

The issue was whether Mr Finnamore was making exempt supplies of land under VATA 1994 Sch 9 group 9. Referring to Maierhofer (C-315/00), the UT noted that the containers, although not mobile, could be easily moved. They therefore fell on the 'movable property side of the dividing line'.

Decision:

The UT then considered whether the supply was a single composite supply. The UT found that no part of the supply was ancillary to the other. For instance, a customer would not use the land without also renting a container. The UT therefore concluded that the elements were so closely linked that they formed a single indivisible economic supply. However, the supply did not qualify as a supply of land (as customers did not choose a particular plot), nor as the letting of immoveable property; it was a supply of storage facilities.

Comments - Self-storage facilities always raise difficult VAT issues as they usually incorporate the supply of land as well as other services. In this case, the fact that the containers could be moved and that clients could not choose a particular plot pointed away from a supply of land.

CRC v Finnamore (trading as Hanbidge Storage Services) v HMRC, Upper Tribunal

9.20 <u>Crucial lack of equipment</u>

Summary – The Tribunal found that the sale did not constitute the transfer of a going concern

In 2005, the taxpayer bought a public house. About 18 months later he sold the property to Claden Ltd for £725,000. The sale proceeds included £100,000 goodwill value. Claden did not buy any fixtures and fittings or equipment. This led HMRC to claim that the company had not acquired an undertaking which could be operated as a business (the equipment was sold to W and S, the owners of Claden). The sale could not therefore qualify as the transfer of a going concern and each element — property, goodwill and equipment — was subject to VAT.

The taxpayer appealed.

Decision:

The First-tier Tribunal agreed with HMRC. The judge found that, without equipment, Claden could not operate the property as a pub, regardless of its intention to do so. The sale did not constitute a transfer of a going concern.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, said: “This case illustrates that the inclusion of goodwill in a sale does not necessarily indicate that a 'business' is being sold that could qualify as a transfer of a going concern arrangement. The inclusion of goodwill is an indicator that a business is being sold but a wider consideration of all facts is needed to arrive at the correct decision. However, it is important that a buyer does not incorrectly pay VAT on the purchase of a business where the transfer of a going concern conditions have been met, otherwise HMRC could seek to disallow input tax on the basis that input tax can only be claimed when VAT has been correctly charged (and at the correct rate) by the seller.”

Pontardawe Inn Ltd v HMRC TC3563

9.21 TOGC and transfer of a law firm

Summary - The FTT found that the sale of part of a business did not amount to a transfer as a going concern (TOGC).

Following the closure of a law firm, its partners had tried to start a new business at the same premises, operating via a company (HSM) set up in the partners' names. They had written to HMRC indicating that they wished to continue the VAT business of the former law firm. However, the initiative had failed and all the partners had agreed to transfer their clients to various practices and to seek employment elsewhere. HSM had therefore been used solely for the purpose of closing down the partnership's business.

HMRC considered that the transfer of the partnership's assets to HSM had constituted a TOGC.

Decision:

The FTT, however, found that there had been no transfer of the partnership's business to HSM. HSM's role had been solely to orchestrate the closure of the law firm by collecting the appropriate monies due to the defunct law firm and paying them to the bank. HSM did not have professional indemnity insurance, it was not regulated by the SRA, it did not have a full complement of staff or premises from which to operate, and it did not give legal advice. The position was therefore similar to Padglade (1995) STC 602. Although it was possible for part of the business of a law firm to be transferred, this had not happened here.

Comments - The case is a reminder that the transfer of the assets of a business will not constitute a TOGC if the transferee does not carry on the same business (or a similar business) as the transferor.

HSM Law v HMRC ([2014] UKFTT 830

9.22 Validity of assessment

Summary - The FTT found that a VAT assessment was out of time.

The issue was whether a VAT assessment — made on the basis that a company had made an error by not recharging certain costs to an associated company — was out of time. This would be the case if the assessment was made more than one year after 'evidence of facts, sufficient in the opinion of the Commissioners to justify the making of the assessment, came to their knowledge' (VATA 1994 s 73(6)(b)). In Pegasus Birds [1999] STC 95, Dyson J had said: 'The person whose opinion is imputed to the commissioners is the person who decided to make the assessment.' The parties agreed that this was a Mr Mintoft. It was therefore necessary to establish when the 'last piece of evidence' was communicated to him. On 30 November 2011, the appellant had provided Mr Mintoft with calculations for the accounting periods in question, which Mr Mintoft had then time apportioned. Arguments that HMRC had not had the right information until the time apportionment was done were robustly rejected. The assessments (made in January 2013) were therefore out of time.

Comments - The case is a reminder that only actual (as opposed to constructive) knowledge by HMRC matters. Time starts running from the point at which its officers actually knew that a VAT assessment must be raised.

Temple Retail v HMRC TC3823

9.23 Direct effect of the directive on cultural services

Summary – The UT found that Directive 77/388/EEC art 13A(1)(n) had a direct effect (i.e it could be relied upon against UK legislation) between 1 January 1990 and 31 May 1996 (the 'claim period').

Article 13A(1)(n) exempted supplies of 'certain cultural services and goods closely linked thereto by bodies governed by public law or other cultural bodies recognised by the member state concerned'. During the claim period, UK domestic legislation did not provide exemption for cultural services; the BFI accounted for VAT at the standard rate on the sale of tickets for admission to screenings of films. The issue was whether the terms of article 13A(1)(n) were sufficiently clear and precise for it to have direct effect and did not permit the member states any latitude or discretion in its application. The answer turned on the meaning of the opening words of the provision: 'certain cultural services'.

Decision:

The UT observed that a 'semantic' interpretation of EU legislation (as suggested by HMRC's counsel) was not appropriate and that a teleological approach was preferable. Articles 13A(1)(n) and 13A(1) (m) must therefore be interpreted in the same way. The CJEU's case law (for instance, EC Commission v Spain (C-124/96)) showed that the term 'certain services closely linked to sport' does not allow member states to exclude some services provided by sport establishments from the exemption. The UT therefore accepted Mr Milne QC's suggestion of substituting 'those' for 'certain' in both articles.

Comments - Although the relevant EU provision contained the term 'certain', the UT found that it was sufficiently precise and not expressed in terms intended to give latitude to member states. It therefore had direct effect.

HMRC v British Film Institute ([2014] UKUT 0370

9.24 Zero rating and the demolition of a building

Summary - The FTT found that the demolition of a building, which retained its façade, did not qualify for zero rating.

Boxmoor had carried out works consisting in the removal of the entirety of an existing building, with the exception of the front façade, and the construction of a replacement dwelling, incorporating that façade.

HMRC issued assessments on the basis that the services supplied by Boxmoor did not constitute the construction of a dwelling (VATA 1994 sch 8 group 5) and were therefore not zero rated. This was because Item 2 Note 16(a) excludes from zero rating the 'conversion, reconstruction or alteration of an existing building'. Note 18(a), however, treats as a new building the demolition of an existing building save for the retention of a single façade as a condition of planning consent.

Decision:

The FTT observed that exemptions should be applied narrowly, that the onus of proof fell on Boxmoor and that the relevant test is objective.

The FTT also noted that the planning consent did not refer to the retention of the façade, which was not surprising given that the consent was not worded in terms of demolition but in terms of alteration and extension. At best, the retention of the façade was therefore part of an understanding between the architects and the planning authorities.

The FTT concluded that whilst, in substance, the works may have amounted to the construction of a new dwelling, the conditions for zero rating were not satisfied.

Comments - The test in Note 18(a) of Item 2 is stringent; the retention of a façade must be a condition of planning consent for zero rating to apply where an existing building is not completely demolished. More generally, the case is a reminder that zero rating is an exemption and that the provisions granting it will be interpreted narrowly.

Boxmoor Construction v HMRC ([2014] UKFTT 833

9.25 Entertainment expenditure (Lecture B854 – 14.24 minutes)

There are many nuances to the rules on deductibility of entertainment and VAT recovery. Mistakes are often made leading to errors in tax returns (for better or worse) so it is important to know the detailed rules and for clients to record costs incurred with full details

Direct tax

Tax law distinguishes staff entertainment from non-staff entertainment.

As every tax practitioner knows, non-staff entertaining is disallowed. Rather less well known is that this includes the cost of client travel to the entertainment event if the business pays for this.

Perhaps oddly, staff travel to client entertainment is allowable if made separately from client travel.

Staff entertaining is allowable if reasonable and for a business purpose, for example rewarding staff for good work or to motivate them ahead of a project to come.

To be staff entertaining, the individual(s) must be an employee(s) of the entity (and not another related entity, for example). It does not include spouses/partners of staff, nor contractors.

If only directors or partners (in a partnership) are entertained, this is disallowed.

Staff entertainment is a taxable benefit for staff unless it relates to annual party/ies costing < £150 per person in total (including VAT) to which everyone is invited – guests have their own £150 limit, so the limit becomes £300 per couple.

Staff lunches provided as hospitality are taxable benefits (not subsistence), as are Friday afternoon drinks at the pub if the employer pays for it.

In practice the employer settles any tax liability on behalf of the employees (using a PAYE settlement arrangement).
This involves grossing up the VAT-inclusive cost for the marginal tax rate of the employees entertained and is therefore expensive and results in Class 1B employers' NIC as well as income tax.

For example if higher-rate taxpayers are entertained for a total cost of £100 plus VAT (£120 gross), the £120 is grossed up to £200 (£120 x 100/60).

The employer then has to pay 40% income tax (£80) plus £27.60 (13.8% x £200) Class 1B NIC. So a meal costing the employer £100 net of the VAT that can be reclaimed, then costs an extra £107.60 in tax and NIC to avoid the employee having to pay tax on the benefit.

VAT

The VAT rules largely mirror those for direct tax, so we look at main purpose of the entertainment. Is it intended principally for staff or non-staff?

If non-staff, then input VAT cannot be reclaimed, but if it is principally staff entertainment, then the business can reclaim VAT on the staff entertainment element, but not for non-staff entertained at same time (but see later)

There is an exception if an overseas customer is provided with hospitality and the expense related to a business meeting on the taxpayer's premises in which case input tax can be claimed on the meal cost without any output tax liability. This cannot apply to corporate hospitality.

Minimising the tax cost

If a business is having a staff party to which staff member's partners/clients are invited, it could make a charge (say £12 – it does not need to be a market price) to the client/spouse.

The business is now supplying entertainment services. It would account for output VAT (1/6th) of £2 and all the input VAT can now be reclaimed.

If a company is entertaining staff from group companies, it is important to recharge the cost. VAT would need to be charged if both businesses are not part of the VAT group, but the other company could reclaim it.

The recharge also shifts the cost to other company for which the individual is employed – this is then allowable in that company as it is a staff-entertaining cost for them.

VAT on necessary subsistence can be reclaimed and the cost is tax-deductible when the travel cost is deductible. This is different to staff entertainment and it is important that businesses distinguish qualifying subsistence from entertainment when paying for food and drink for staff.

Contributed by Malcolm Greenbaum

9.26 Flat rate categories and task force (Lecture B855 – 13.36 minutes)

HMRC have set up task force teams in some parts of the country to challenge the chosen flat rate categories of many businesses, mainly focusing on workers in the oil sector. The team's strategy seems to be to try and recategorise these workers from their chosen category of 'business services that are not listed elsewhere' (with a 12% flat rate percentage) into the category for 'architects, civil and structural engineers or surveyors' with a rate of 14.5% - and to assess the 2.5% difference on a retrospective basis for the last four years (or from the date when the worker joined the scheme if later) ie the error correction period that applies in the world of VAT.

Flat rate categories – background

A key point of principle with the flat rate scheme (FRS) is that the choice of category is down to the taxpayer. It is a waste of time asking HMRC for a decision about whether a client should be classed as eg a 'lawyer' or 'hairdresser' – they will refuse. A taxpayer must make his own decision about the category he must adopt and my thinking as far as this challenge is concerned has always been very clear and is shared with you at Box 1.

Box 1 – choosing a flat rate category

- Consider how you would describe your business activity to a person you have just met for the first time eg at a party. Use everyday words where possible eg lawyer, hairdresser, accountant.

- Review the list of 55 FRS categories (http://www.hmrc.gov.uk/manuals/frsmanual/FRS7300.htm) to see if there is an exact match with the activity and the category description.

- If there is not a match between the category and activity, then the business must choose one of the two miscellaneous categories ie 'any other activity that is not listed elsewhere' or 'business services that are not listed elsewhere'. The choice between these two is not really important because they have the same flat rate percentage of 12%.

- HMRC give examples in the above link of trades they think are included within each category but these examples do not have the force of law and are for guidance only. It is still up to the taxpayer to make a decision concerning his appropriate category.

What if HMRC disagree?

So what happens if a business joins the scheme and then in three years' time HMRC conduct a review and disagree with its choice?

HMRC's guidance in VAT Notice 733 is very clear and reproduced in Box 2 and the basic outcome is that if the taxpayer has made a 'reasonable choice' with his chosen category, then any HMRC challenge should be in relation to future periods only. They should not seek to raise an assessment for historic periods.

Box 2 – HMRC disagreement with chosen flat rate category – extract from VAT Notice 733, para 4.2

What if I get the sector wrong?

We will not normally check your choice of sector when we process your application. So if you have made a mistake you may pay too much tax or too little. Paying too little could mean that you are faced with an unexpected VAT bill at a later date.

However, if we approve you to join the scheme, we will not change your choice of sector retrospectively as long as your choice was reasonable. It will be sensible to keep a record of why you chose your sector in case you need to show us that your choice was reasonable.

Note: Some business activities can reasonably fit into more than one sector. So changing your sector does not automatically make your original choice unreasonable.

Historic case law

In the case of *The Chilly Wizard Ice Cream Co Ltd* (VTD 19977) the taxpayer successfully argued that its ice cream kiosk in Bournemouth which also had two plastic chairs outside for customers to sit in and relax was a business that was 'retailing food, confectionary, tobacco, newspapers or children's clothing' rather than providing 'catering services including restaurants and takeaways' as HMRC thought. This is sensible – would the proprietor of an ice cream kiosk really describe his business as a restaurant? To quote from the tribunal report:

'We have found that on the evidence before us:

(1) there is no catering and no supply of 'catering services' here;
(2) there is no restaurant here;
(3) there is no takeaway here;
(4) retailing is an appropriate categorisation, and catering is not.

Accordingly, as catering is not the right categorisation, and retailing is, the appeal is allowed with costs.'

Note - with a current VAT rate of 20%, the 'catering' category is 12.5% and the 'retailing food' category is a much lower 4%, so the tax involved in the Chilly Wizard case was considerable.

HMRC also lost the case of *Calibre Tas Ltd* (VTD 20508), which was again linked to the 'business services that are not listed elsewhere' category, which had been chosen by the taxpayer instead of HMRC's preferred choice of 'management consultancy' (the current rates are 12% and 14% for these categories). The company successfully argued that it was supplying the services of a 'forensic employment consultant and expert witness' which was not 'management consultancy'.

Is a mechanical engineer a civil or structural engineer?

In the recent cases of *Idess Ltd* (TC3638), the facts were as follows:

- The company's activity was 'mechanical engineering' – and the director had chosen the category of 'any other activity not listed elsewhere' as far as the FRS is concerned ie a rate of 12%.

- HMRC classified the business as 'architects, civil and structural engineers or surveyors' with a higher rate of 14.5% and raised an assessment for £8,891 to recalculate the company's FRS liability from 2009 to 2012.

- The tribunal accepted the taxpayer's view that he was not a civil engineer/surveyor etc – this category was associated with expertise linked to land and buildings, whereas the director's skill was linked to machinery and equipment.

To rub salt into the wounds, and to make the case even more incredible, HMRC originally charged the company a 35% penalty on the £8,891 assessment 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. But both the assessment and tribunal were overturned by the court.

What about the oil workers?

Going back to the oil workers in Scotland, my opening strategy would be to examine the letters of engagement/contracts of service between the workers and the oil company to see exactly what services are being provided and how they are described. If the contract uses phrases such as 'civil engineer' or 'structural engineer' then we have an exact DNA match so to speak between the business activity and the FRS category – but if the activity is to service machinery or a similar activity, then we are back to the Idess case again.

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