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Contents

Personal Tax

Not too late for NI contributions

Summary – The Tribunal held that Class 2 NICs could be paid late due to lack of knowledge

In 2012, the taxpayer discovered that, although he had been registered as self-employed with HMRC since 1995, he had not paid any class 2 National Insurance because he had not informed the then Department of Social Security about his status. HMRC told him he could pay only the period from April 2009 unless he could show that the failure to pay the contributions was due to his ignorance and error.

Decision:

Following the decision in Dr J Schonfield (TC2658), where the tribunal had allowed the appeal because the taxpayer had relied on his accountant to deal with his financial affairs, the First-tier Tribunal noted that the taxpayer had appointed an adviser who had been recommended to him. The adviser had helped him set up in practice as a sole practitioner, arranged his VAT registration, and dealt with all his tax affairs.

The taxpayer's failure to pay the contributions was because of his lack of knowledge. This was not due to a failure on his part to exercise due care because he had relied on his accountant.

The taxpayer's appeal was allowed.

Comments – There have been a number of cases such as Kearney v HMRC where individuals wish to pay contributions after they would normally do so. The Tribunal apply a strict test to this. In this case the taxpayer's failure to pay the contributions was because of his lack of knowledge. This was not due to a failure on his part to exercise due care because he had relied on his accountant.

S Murphy v HMRC TC3855

Contributions to a FURBS taxable

Summary - The FTT found that contributions to a FURBS were taxable in the hands of the employees.

The issue was the liability of employees and directors in respect of in specie contributions of property to a funded unapproved retirement benefits scheme (FURBS) made by their employer, a construction company. It was accepted that the contribution could amount to employment income (ITEPA 2003 s 386). The taxpayers contended, however, that the company did not contribute the properties in respect of any particular individual, so that the contributions were not taxable. HMRC contended that an express or implied allocation had taken place and that, in the alternative, the value should be apportioned between the taxpayers (ITEPA 2007 s 388).

Decision:

The FTT first rejected HMRC's suggestion that the tax treatment of the arrangement depended upon whether a tax avoidance purpose could be established. Such a motive was irrelevant, unless the applicable statutory provisions incorporated a motive test. The FTT also thought that it must be possible for an employer to 'top-up' a FURBS without specific allocation. It noted, however, that 'there seems little sense in Parliament taxing specific contributions but leaving untaxed general funding'. The FTT also thought that s 388 is designed to address the issue of unallocated payments to FURBS.

The FTT concluded that the main point was that 'the sum paid by the company to the FURBS was with a view to the provision of retirement benefits to three employees in the amounts that were eventually paid' and which were agreed at the outset — although formally recorded later on. These amounts were therefore taxable under s 386. Furthermore, s 388 operated to apportion the residual value of the properties between the remaining two employees.

Comments - Although the FTT accepted that the arrangements were not a sham, it found that the contributions to the FURBS had been informally allocated so that they were taxable. This case predates the disguised remuneration provisions as it related to transactions in the year to 5 April 2006 but demonstrates why there are provisions on earmarking in the ITEPA Part 7A provisions on disguised remuneration.

Philpott and Others v HMRC [2014] UKFTT 853

Employment not established between the parties

Summary - The FTT found that no employment relationship existed between the appellant and its contractor.

EMS engaged in recovering damaged or otherwise immobilised vehicles on behalf of insurance companies. Mr Makings had established his own business, DKM Services, in 1996. It was accepted that, as DKM Services, he drove for a number of companies. However, during the relevant period, DKM Services had relied on the work it was given by EMS to the exclusion of all other former business contacts. This was done informally; Mr Parker, the director of EMS, would telephone Mr Makings and let him know which vehicles needed to be collected. Mr Makings was paid an hourly rate in arrears on presentation of invoices.

Decision:

The FTT observed that the burden of proof was on EMS to show that Mr Makings was self-employed and that there was no 'magic formula'. Referring to the criteria established by Ready Mixed Concrete [1968] 1 AER 433, the FTT noted that Mr Parker had no control over the way Mr Makings discharged his duties. Mr Makings was also taking financial risks; he had invested in his business both in terms of equipment and in terms of personal training. Furthermore, he provided his own equipment and did not enjoy the benefits of an employee. Finally, Mr Parker did not have exclusive rights to his services.

Comments - This is a useful example of the way the well-known tests established in Ready Mixed Concrete are applied. The position was reasonably clear cut, as most of the criteria pointed away from an employment contract. However it provides good revision of the tests to determine employment v self-employment.

EMS (Independent Accident Management Services) v HMRC [2014] UKFTT 891

Capital Taxes

Assets transferred offshore

Summary – The tribunal found the assets in question had been transferred offshore and there was a power to enjoy.

The taxpayers, a married couple, owned three companies that provided residential care to the elderly, and also owned the properties from which two of the companies operated. They established settlements in the Isle of Man, which acquired two Isle of Man incorporated companies, Calinda and Mannville. The taxpayers transferred the properties to Calinda and Mannville, which resulted in rents being paid to those companies. From the profits arising from those rents, the companies declared dividends.

HMRC decided the dividends should be treated as taxable income of the taxpayers by virtue of TA 1988, s 739 (now ITA 2007, s 720).

The taxpayers appealed.

Decision:

The First-tier Tribunal said the evidence showed that, as well as being creditors of Calinda, the taxpayers were debtors of it and that the sum owed was reduced by the dividend. There was also evidence to show that the taxpayers had "power to enjoy the income of Calinda as a matter of fact".

The tribunal was unsure whether, under the terms of the transfer of the property to Mannville, the taxpayers were creditors of that company. The judge concluded that they were entitled to receive capital sums under TA 1988, s 739. He added that it seemed that the scheme embarked on by the taxpayers "had as its object the shelter from UK tax of all the income arising from their nursing homes". The income of the offshore settlements was deemed to be their income by reason of their power to enjoy it.

The taxpayers' appeal was dismissed.

Comments – The provisions of Section 720 ITA 2007 (formerly the well-known s739 ICTA 1988) have been around for a long time and most practitioners are aware of their existence even if they do not regularly deal with the provisions. It was quite clear to the Tribunal that the transactions were well within the provisions and accordingly the taxpayers' appeal was dismissed. The term "power to enjoy" is a very widely drawn term as it needs to be in an element of anti-avoidance legislation.

R and G Seesurrun v HMRC TC3900

Two defences against an assessment not allowed

Summary – The tribunal determined that the taxpayer was not entitled by procedural manoeuvres to have two arguments tested separately against the discovery assessment.

The taxpayer, John Hargreaves, was the largest shareholder in Matalan. In May 2000, he sold a large tranche of his shares and made a substantial capital gain. So as to escape liability to capital gains tax on the disposal by becoming non-resident, he left the UK in March 2000 and moved to Monaco.

In his 2000/01 tax return, he completed the non-residence pages of the return, stating he intended to live outside the UK permanently.

In January 2007, HMRC issued a notice to the taxpayer for 2000/01, assessing him to capital gains tax on the disposal of his Matalan shares. They also issued him with a notice of determination of ordinary residence for 2000/01 and 2001/02.

The taxpayer appealed, but this was delayed because he also applied for judicial review to quash the residence notification, on the ground that HMRC had failed to apply the terms of their booklet IR20. After the Supreme Court ruled against the taxpayer in a similar case, R (on the application of Gaines-Cooper) v CRC [2011] STC 2249, the taxpayer discontinued his judicial review claim and continued with the appeal.

One of the taxpayer's grounds of appeal against the capital gains tax assessment was that it was made under TMA 1970, s 29 (discovery) and HMRC had no power to do this. He applied to have this heard by the First-tier Tribunal as a preliminary issue. The tribunal dismissed it, concluding that there was no reason to distinguish it from the decision in Hankinson v CRC [2012] STC 485. The taxpayer appealed to the Upper Tribunal.

Decision:

The judge noted that it was for HMRC to prove their case in relation to s 29(4) and s 29(5). Further, he agreed that if this were the only issue, the taxpayer could insist on HMRC opening the case and calling for evidence first. However, the taxpayer was also relying on s 29(2) where it was for him to establish that there was a generally prevailing practice.

In this instance, the taxpayer could confine the appeal to one issue only by abandoning his attempt to establish his non-residence. The judge said that, in effect, the taxpayer wanted two opportunities to challenge the assessment:

"first by a preliminary hearing of the competence issue at which he can call no evidence if so advised; and then if he loses that challenge, at a subsequent hearing of the substantive issue at which he can deploy his evidence to the full."

He concluded that the taxpayer was "attempting a procedural manoeuvre by which he can have two separate bites at the cherry".

The taxpayer's appeal was dismissed.

Comments – This has been a long running saga of which this is the latest element. The decision by the judge highlighted that the taxpayer was attempting to put himself at an advantage over HMRC in terms of the strategy where he could deploy his arguments in determining the issue. This is a case where the new SRT if it had been applicable would have given certainty in determining residence status and of course ordinary residence status has now been abolished.

John Hargreaves v CRC, Upper Tribunal

Claims could made by executors if they could have by the deceased

Summary - The FTT found that executors could make optional claims which could have been made by the deceased.

The appellants were the executors of the deceased who had bought shares in two limited companies (for £25,000 in each) and made a loan of £334,784 to a third.

HMRC had accepted that the two shareholdings were valueless and that the loan had ceased to exist as an asset as a result of the liquidation of the debtor. The deceased had been served with a notice to file a tax return on 6 April 2010 and had died in a motoring accident on 11 May 2010. His executors then filed a tax return in January 2011 claiming losses of £40,000. In doing so, they relied on ITA 2000 s 131, which allows a capital loss (recognised under TCGA 1992 s 24) to be set against income. They claimed that the balance should be carried forward to be set off against future capital gains (TCGA 1992 s 253).

HMRC contended that a s 131 claim could only be made by the owner of the shares and that, similarly, the s 253 claim could only be made by the lender.

Decision:

The FTT found that HMRC's interpretation of s 24 was 'overly literal'. The date of the claim (as specified in the return) was 5 April 2010 and all the conditions of s 24(2)(b) were fulfilled at that time.

As to the capacity in which the executors had filed the return, the FTT noted that there was nothing in TMA 1970 to require executors to file returns for the pre-death period — although they normally do so as they are liable for the tax. Furthermore, there was no provision covering the situation where the deceased had the right to make optional claims to reduce his liability.

Relying on TCGA 1992 s 62, the FTT concluded that Parliament's intent must have been that 'losses available to the deceased in his lifetime would be available after his death to be offset against gains in his lifetime'. The FTT added that the right to make claims, must, as a matter of common law, transfer to the executors. This was unless the statute expressly provided that claims died with the deceased, but the statute contained no such provision. However, this purposive interpretation did not allow the executors to make a claim covering a period after death, as they would then be returning their own liability. The same applied in relation to the loan.

Comments - The case raised difficult issues which were not expressly covered by the legislation. In confirming that a claim can be made by executors, provided that it refers to a time when the deceased was still alive, this case may be a useful reference to executors beyond the sphere of negligible value claims.

Drown & Leadley v HMRC [2014] UKFTT 892

The ramifications of Roelich v HMRC on incorporation (Lecture P856 – 21.56 minutes)

When an individual transfers a business as a going concern to a company, together with the whole of the assets of that business (other than cash), in exchange for shares issued by the company, S162 TCGA 1992 applies to roll any inherent capital gains on the business assets into the shares. A key issue here is that the activity which is transferred to the company must be a business.

The Upper Tribunal in Ramsay v HMRC (2013) established that a business for this purpose can include the letting of property, provided that the landlord's activities:

- represented an occupation or function actively pursued with reasonable or recognisable continuity;
- were conducted in a regular manner and on sound and recognised business principles; and
- were of a kind commonly engaged in by those who seek to profit from them.

Recently, the First-Tier Tribunal has had another opportunity to consider what is meant by the word 'business' for the purposes of relief under S162 TCGA 1992 in Roelich v HMRC (2014). In this case, the taxpayer (R) carried on an activity described as a property development consultancy business. He advised on projects involving property development and on how these might be undertaken or progressed advantageously.

In May 2006, R transferred his business to a company in exchange for shares and stated that the provisions of S162 TCGA 1992 applied to him on this transfer. HMRC disagreed, saying that there was no transfer of a business as a going concern – there was merely the transfer of an income stream which did not amount to a business and which did not include the whole of the assets of the business. HMRC also argued that R's activities included the exploitation of his professional knowledge and experience but that these skills were personal to him and so incapable of being transferred to the company (this argument has a clear resonance on HMRC's approach to the transfer of goodwill).

The Tribunal considered three important points:

- whether there was a business;
- whether that business was capable of being transferred; and
- whether it was in fact transferred.

The Tribunal judges were in no doubt that R carried on a business and that the business was capable of being transferred as a going concern to the company. The question of whether R's skills were personal to him was dealt with by the Tribunal comparing the difference between being a portrait painter or a singer where an individual's talent is clearly not transferable and many other activities where skills can be learned by someone else even it if takes time. They said:

'For example, an accountant may start in business on his own and use his experience and contacts to create a successful business, but there is no reason why he cannot transfer that business to another practice particularly if he works in the new business for a period after the merger so as to facilitate the success of the merged activity. R had a specialised knowledge of the waste business and its associated regulation and also knew who best might get the work done, but nothing of this impressed us as being knowledge which was incapable of being passed on to others.'

There were one or two evidential difficulties arising from a shortage of documentation, but, on the evidence of R and the conduct of the relevant parties, the Tribunal concluded that a transfer had taken place and that S162 TGCA 1992 applied.

There was one point which was touch and go. The company's tax return stated that a particularly important contract was acquired from R in exchange for an issue of shares in the company. HMRC zeroed in on these words as evidence that the issue of shares was for that particular contract and not for all the assets of the business. Therefore, the transaction did not satisfy the terms of the CGT provision. Fortunately for R, the Tribunal decided that the shares were issued in exchange for all the assets of the business, despite this unfortunate wording, and so R's relief was not prejudiced.

Contributed by Robert Jamieson

Entrepreneurs' relief – employee or not? (Lecture B856 – 17.21 minutes)

Unlike its predecessor (taper relief), the entrepreneurs' relief legislation has spawned a number of cases during the first few years of its existence. The latest one is Corbett v HMRC (2014) which was heard by the First-Tier Tribunal in Birmingham.

In essence, the facts were simple. The taxpayer (Mrs C) had disposed of 1,500 shares in Optivite International Ltd (an unquoted trading company) on 7 October 2009. Her 2009/10 tax return included a claim for entrepreneurs' relief on that disposal which HMRC disallowed. Mrs C appealed against that decision.

June 2008 saw the start of negotiations relating to the potential acquisition of Optivite International Ltd by an AIM-listed company (K). Detailed (non-binding) heads of terms were contained in a letter from K dated 2 February 2009 and the sale took place some eight months later.

Mrs C was an employee of Optivite International Ltd. She acted as a secretarial assistant to her husband who was the company's sales director.

She worked from home, as did her husband between his many trips abroad. Her salary of £14,000 was paid into the couple's joint bank account. However, towards the end of February 2009, she was removed from the company's payroll because the management of K were known not to approve of the policy of employing spouses of senior executives and it was felt that her continued position in the company could interfere with the negotiations which, by then, had reached a delicate stage.

However, after February 2009, Mrs C continued to perform the same secretarial duties as before and, from March 2009, the husband's salary was increased by the same amount as had previously been paid to his wife. When the sale was concluded later in the year, the new owners insisted that the sales director had an office on site and so Mrs C's role was superfluous. The office at home was closed down.

The question which arose was whether Mrs C had been an employee of the company throughout the 12-month period from 8 October 2008 to 7 October 2009 in accordance with the requirement in S169I(6) TCGA 1992. It is understood that all the other conditions in order for entrepreneurs' relief to be available were satisfied.

HMRC argued that, for the period from the end of February up to 7 October 2009, Mrs C was not an employee of the company. They used the decision in the well-known case of Ready Mixed Concrete (South East) Ltd v Minister of Pensions (1968) as authority for this stance. They also pointed out that, had Mrs C remained an employee of the company (which of course they disputed), the company would then have been in breach of its national minimum wage obligations.

Mrs C's accountant stated that Mrs C had remained an employee of the company until it was acquired by K in October 2009. He confirmed that, from March 2009 onwards, she had performed exactly the same duties and in exactly the same way as she had done previously. This indicated that there was an implied contract of employment up until the sale of the company. He pointed out that the Ready Mixed Concrete case on which HMRC relied had been heard more than 45 years earlier and that the practicalities of employment relationships had changed considerably since then. In addition, he commented that HMRC's point about the national minimum wage was a bad one, given that Para CG64110 of the Capital Gains Manual contains the following sentence in relation to entrepreneurs' relief:

'There are no specific requirements regarding either working hours or the level of remuneration.'

And anyway the national minimum wage requirement had been satisfied by the increase in the husband's salary which went into the couple's joint bank account. Thus it could be said that Mrs C did continue to receive consideration for the duties which she performed.

Faced with this evidence, the First-Tier Tribunal gave their judgment with these words:

'We are satisfied, on the balance of probabilities, that the company continued to remunerate Mrs C after February 2009 by directing her salary to her husband . . . and that that, taken together with her continued performance of her duties, is sufficient for her to have continued to be an employee of the company in the period from February 2009 to October 2009.

Accordingly, the condition in S169I(6) TCGA 1992 is satisfied and Mrs C is entitled to entrepreneurs' relief in respect of her disposal of the shares.'

Two comments might be appropriate in conclusion:

1. It has always been argued that, while directors of family or owner-managed businesses do not need to be paid a salary (given that many of them draw substantial dividends from their company), the same did not hold good for employees and that it would always be sensible to remunerate employees in order to ensure the availability of entrepreneurs' relief. This case suggests that non-payment of any salary to an employee may not be a problem.
2. Although Mrs C appears to have been a basic rate taxpayer, presumably her husband (as sales director) was not. When Mrs C's salary was transferred to the husband in March 2009, would not the couple have then been worse off in after-tax terms? The salary transfer should have been effected so that the couple remained in more or less the same net financial position.

Contributed by Robert Jamieson

IHT on gift as not to a charity

Summary - High Court found that a disposition in a will was subject to IHT, as it was not a gift to charity.

Mrs Coulter died in Jersey in October 2007, leaving the residue of her estate to a trust for the benefit of the Parish of St Ouen to provide homes for the elderly of the parish. The disposition was subject to conditions and provided that, if they were not fulfilled by the parish, a disposition should instead be made to Jersey Hospice Care.

HMRC did not accept that the gift was exempt from IHT. A deed of variation of the trust provided for an absolute gift of £10,000 to Jersey Hospice Care and an absolute gift of the residue to the appellants to use for the purpose of the construction of homes for the elderly of the parish.

Under IHTA 1984 s 23(6), a gift is exempt from IHT if it is held on trust for charitable purposes. It was accepted that the trust was set up for UK law charitable purposes; however, HMRC contended that there was an implied requirement in the provision that the trust be governed by UK law.

Decision:

Agreeing with HMRC, the High Court found that the trust did not qualify for exemption. Referring to Dreyfus [1956] AC 39, the High Court noted that it would be incongruous to require a court to ascertain whether the purposes of a body governed by foreign law were UK law charitable purposes.

Comments - Following this case, practitioners should ensure that trusts set up by wills for UK charitable purposes are governed by UK law. If not, the relevant disposition will be subject to IHT.

Routier and anor v HMRC [2014] EWHC 3010

Useful gilts (Lecture P857 – 9.05 minutes)

Summary – FOTRA investments can be a useful planning vehicle for non-residents who have yet to lose their UK domicile.

The Treasury can issue securities with the condition that they are exempt from UK taxation as long as they are beneficially owned by persons who are not resident in the UK – these are known as FOTRA ('free of tax to residents abroad') securities. Since 6 April 1998, all gilts have had FOTRA status, irrespective of their terms of issue. Interest payments on such securities can be made without deduction of income tax and the capital value of FOTRA investments is not subject to IHT in the hands of a non-UK resident investor.

Gilts which are owned by a settlement where the life tenant has a qualifying interest in possession represent excluded property if the beneficiary who is entitled to the interest is resident outside the UK (S48(4) IHTA 1984). Note that the domicile of both the settlor and the beneficiary is irrelevant.

In practice, this exemption is most useful for the individual who is UK-domiciled under general law (or who is deemed to be domiciled here) but has left the UK and ceased to be UK-resident. Such an individual can invest in FOTRA securities in order to protect his IHT position until such time as he has lost his UK domicile. Note that, following FA 2013, he can no longer borrow on the security of UK situs assets (such as real estate) and invest the proceeds in gilts.

A particular advantage is that there is no minimum holding period for the FOTRA investments. In other words, the exemption takes immediate effect.

Illustration
Chris is a non-UK resident life tenant of a will trust established by his deceased brother, Nick, in February 2005. Chris is still UK-domiciled, but he now lives in Monaco. Chris finds out in the autumn of 2014 that he is seriously ill.

The trustees can protect Chris' IHT position by investing in UK gilts given that non-UK residence only is required.

On Chris' death, there is no IHT charge given that the gilts represent excluded property. It does not matter that Chris was still UK-domiciled or that Nick (the settlor) was the same.

Contributed by Robert Jamieson

Administration

Penalties arose from no response

Summary – The Tribunal confirmed penalties arising due to a lack of response from the relevant taxpayers

Mrs Sootheran died on 30 October 1976 and left a property to her husband. Her husband and her brother, Herbert Evans, were appointed executors. Hugh Warwick Evans and Richard Evans were subsequently appointed as trustees with the original executors.

The husband died on 1 January 2010 and the residuary estate passed to Mrs Sootheran's nephews and nieces. Richard Evans was the sole surviving trustee liable for the inheritance tax.

HMRC wrote to Mr Evans six times between 13 August 2010 and 6 August 2013 and also tried telephoning him but received no response. Finally, they sent him a notice of determination which stated the value of the property at the date of Mr Sootheran's death was at least £65,473 and that inheritance tax of £22,550.28 together with interest of £2,332.66 was due. The department then applied to the First-tier Tribunal to impose penalties under IHTA 1984, s 245 for the failure to submit final accounts and information.

Decision:

The First-tier Tribunal granted HMRC's request and imposed two penalties of £100 and a further penalty of £60 to be paid for each day from the date of the release of the tribunal's decision until an appropriate account was submitted.

The judge expressed concern at the lack of response from Mr Evans, whom he surmised could be elderly and unwell. He recommended that a representative from the local tax office visit him to ascertain the reasons for his failure to respond to the department's letters and telephone call. HMRC's application was accepted.

Comments – This is an interesting case involving taxpayers who are potentially elderly and reliant on each other for the responsibilities. The judge quite rightly raised a number of issues. The taxpayers' charter has a number of responsibilities including that of helping and supporting. This would appear to be a classic example of where that is relevant.

HMRC v Richard Evans TC3759

Missing documents for HMRC check

Summary – The Tribunal upheld the penalty was upheld, but reduced the amount of daily penalties from £40 to £20 in respect of documents requested by HMRC.

The taxpayer, a dentist, appealed against a penalty of £5,620 imposed under FA 2006, Sch 36. He had failed to comply with a notice requiring documents to enable HMRC to check the taxpayer's expenses claim. The expenses, amounting to £160,000, were mainly payments to a trust.

The HMRC officer investigating said the trust was a marketed tax avoidance scheme. Some of the documents had been produced by the taxpayer's adviser, but legal professional privilege was claimed in respect of others.

HMRC asked the adviser to itemise the documents considered to be subject to legal professional privilege but this was not done. Eventually, the adviser told HMRC that all the documents that existed had been submitted. HMRC insisted that further documents pertaining to the trust were required, such as engagement terms, contracts and invoices.

Decision:

The First-tier Tribunal agreed that the other documents must exist, saying the taxpayer was unlikely to have paid over such an amount to the trust without guidance.

The penalty was upheld, but the tribunal reduced the amount of daily penalties from £40 to £20.

The taxpayer's appeal was dismissed.

Comments – HMRC are entitled to examine documentation with regard to a taxpayer’s affairs and this is particularly true where marketed tax avoidance schemes are involved. The issue of legal professional privilege is another matter and would need to be properly established in respect of the papers with Freeman and Co. , the taxpayers advisors.

Dr RM Hughes v HMRC TC3866

Fraudulent claim

Summary – The Tribunal concluded that the expenditure claim in a Capital Gains Tax computation was fraudulent.

A company, Clarisa, bought four properties from Mr S, who was a director of the company. In 2007, the company sold one of the buildings. The director said that the company had incurred expenditure of £360,000 on all four properties, and claimed a proportion of that amount against the disposal proceeds. This resulted in a capital loss of £41,175.

HMRC questioned the £360,000 expenses. It transpired that the sum had been incurred much earlier in the company's ownership of the properties and covered improvements and refurbishment. HMRC said much of the expenditure would have been dealt with as revenue expenses and set against the taxable rent. The rest would not be deductible in a capital gains tax computation. They imposed a penalty.

Decision:

The First-tier Tribunal agreed with HMRC. It found that it was “absolutely clear that no expenditure remotely totalling £360,000 had been incurred in 2007”. Further, Mr S had been unable to account accurately as to how the money had been spent. The judge concluded the claim was fraudulent.

The tribunal said HMRC's mitigation of the penalty had been “excessive”, but the judge decided against increasing it in view of Mr S's poor health.

Mr S and his partner also appealed against assessments raised by HMRC in respect of the private use of a car owned by the company. The tribunal dismissed this also on the basis that there was no evidence to show that private use of the car was forbidden.

Comments – It is crucial for the correct levying of tax that the computation of tax is performed properly and correctly. In this case the taxpayer was attempting to “have their cake and eat it” in using expenditure both in reducing taxable income and capital gains. In addition they were attempting to set off non-deductible expenditure. Consequently the Tribunal quite correctly held that they were fraudulent.

F Swain, H Swain, Clarisa Ltd v HMRC TC3896

Wrong deductions as computed without care

Summary – The Tribunal found that the employer had not taken reasonable care

On 24 October 2008 the taxpayer left his employment with T. His P45 stated his tax code was 375L month 1 but did not include details of income and tax. On 1 November 2008 he began working for A and gave it a copy of his P45. A calculated his pay as if he had no other earnings for the year instead of adopting the month 1 basis. This resulted in a tax underpayment for 2008/09.

Initially, HMRC wrote to A demanding the underpaid tax. However, they later wrote to the company saying they had made a direction under reg 72(5) condition A of the Income Tax (PAYE) Regulations 2003 that the company was not liable to pay the tax under-deducted because HMRC were satisfied that it had taken reasonable care to deduct the correct amount of tax from the relevant payments. On the same day HMRC issued a direction to the taxpayer demanding the underpaid tax from him.

The taxpayer appealed. He said A had failed to administer PAYE correctly, had not exercised proper care and attention, and had not had the necessary controls, checks and balances in place to prevent the incorrect administration of PAYE.

Decision:

The First-tier Tribunal was surprised that the employer had not questioned the lack of information on the P45 about the taxpayer's previous pay and tax details. The taxpayer would have been aware of his previous income, but he was settling into a new job and relied on his employer to make the correct deductions. He had provided payslips to A when he was employed, and the employer could have used this information to check his previous pay position.

The tribunal agreed with the taxpayer that the employer had not taken reasonable care. The taxpayer's appeal was allowed.

Comments – This case demonstrated how PAYE had not been operated carefully and what consequences can follow therefrom. The circumstances were such that the employer should have identified from the paperwork the income levels and therefore the PAYE that should have been applied.

Ted Sparrey v HMRC TC3940

Penalty applies

Summary – The Tribunal effectively reduced penalties which still applied because of wrong allocations by HMRC

The taxpayer made payments of PAYE and National Insurance late in 2011/12. HMRC imposed penalties under FA 2009, Sch 56. The taxpayer appealed. The director of the company said he had been in “constant contact” with HMRC about an oversight in paying the tax and problems with the payroll bureau. Penalties had not been mentioned in those discussions. Furthermore, the company had no assets and could not afford to pay the sums demanded. In addition, when the company made PAYE payment of £5,512, HMRC allocated it to more recent debts instead of older ones because the company had not specified how the amount should be used.

Decision:

The First-tier Tribunal told HMRC to apply the sum to extinguish the earliest debt. This led to the penalty being recalculated and reduced. The judge said that insufficiency of funds could not in general constitute a reasonable excuse for late payments and there were no special circumstances that could be applied. The penalty was due.

The taxpayer's appeal was dismissed.

Comments – This case demonstrates the importance of procedures and how the payment should be identified to ensure that the earliest debt is paid off first.

C & DDH Ltd v HMRC TC3810

Late appeal and reasonable excuse

Summary - The FTT dismissed an application to appeal out of time.

Mr Chen contended that assessments issued by HMRC in November 2011 were excessive; however, he had not appealed until November 2013. Mr Chen's counsel explained that Mr Chen, who cannot read English, had relied totally on his former accountant and had not been aware of any issue until a charge for payment had been served by Sheriff Officers.

Decision:

The FTT observed that reliance on a third party can constitute a reasonable excuse, but that a taxpayer must act 'with reasonable prudence and diligence in dealing with his tax affairs'. The FTT also noted that the discretion to allow a late appeal is wider than the discretion which applies in relation to reasonable excuse for the purpose of specific legislation.

The FTT found, however, that Mr Chen had not established a reasonable excuse. At a meeting with HMRC in September 2011, HMRC officers had stressed the need for cooperation and action. Furthermore, Mr Chen had confirmed that he had his mail translated to him; he must therefore have appreciated the seriousness of the situation. Finally, the habit of Mr Chen of forwarding correspondence to his accountant every six months displayed 'a complete disregard for the management of his tax affairs'.

The FTT added that the merits of the substantive case were poor and that HMRC had been entitled to assume that the assessments had been accepted.

Comments - The FTT recognised that it had a wide discretion to accept the existence of a reasonable excuse, but considered that it did not apply in this case as the taxpayer must have been aware of the issues long before he appealed.

Tian Chai Chen v HMRC [2014] UKFTT 848

Discovery assessments and related appeals

Summary - The FTT dismissed an appeal concerning tax planning arrangements involving the surrender of second hand life insurance policies, similar to those implemented in Drummond [2009] STC 2206.

The taxpayer submitted his 2003/04 tax return on time and claimed capital losses of about £2.6m. In October 2006, HMRC examined the return and concluded the taxpayer had taken part in an avoidance scheme involving second-hand insurance policies. They issued a notice under TMA 1970, s 20(1) but the taxpayer did not comply, instead seeking a judicial review to have it set aside.

The Court of Session dismissed the taxpayer's application in May 2009 (Pattullo v CRC [2010] STC 107).

In the meantime, the Court of Appeal ruled in J Drummond v CRC [2009] STC 2206 that a similar avoidance scheme did not work. This satisfied HMRC that the taxpayer's return was incorrect and they raised a discovery assessment in the sum of £835,400. The taxpayer appealed.

Decision:

The first issue concerned the validity of a discovery assessment issued in relation to the taxpayer's 2003/04 return. Firstly, the taxpayer contended that there had been no discovery within the meaning of TMA 1970 s 29(1). Although HMRC had been investigating similar schemes since 2005, the FTT found that the turning point was the release of the Court of Appeal's decision in Drummond in June 2009, endorsed by the refusal to give permission to appeal to the Supreme Court in November 2009. At that stage, 'what may have been a suspicion, even a strong suspicion, was converted to the positive view that there was an insufficiency of tax'. The FTT also referred to the disclosure made by the taxpayer on his return as 'part of the cat and mouse game played by promoters of tax avoidance schemes … to provide sufficient information to avoid the opening of an enquiry and to negate or reduce the prospect of a discovery assessment after the enquiry window has closed'.

Secondly, the taxpayer argued that a 'hypothetical' HMRC officer could reasonably have been aware of the insufficiency of tax at the time the enquiry window closed (TMA 1970 s 29(5)). The FTT observed, however, that it would be unreasonable to expect an HMRC officer to be aware of the arcane world of capital redemption contracts. Furthermore, even if such an officer had been aware of the Drummond appeal, at most he would have had a suspicion that there was a tax insufficiency, but not an awareness that this was the case.

The FTT also found that the issue of validity had not already been determined (res judicata). The judicial review application in relation to the issue of an information notice did not exclude the statutory right of appeal against a discovery assessment.

Finally, the FTT refused to allow the taxpayer to amend the grounds of appeal in order to include the substantive issue, i.e. whether the scheme actually worked. This part of the appeal was motivated by the fact that a number of appeals turning on similar facts were pending, and the taxpayer wished to join the 'bandwagon'.

The FTT pointed out however that, following Drummond, the chance of these appeals being successful was remote and that the taxpayer's argument in this respect was vague.

Comments - After Langham v Veltema [2004] STC 544 and Charlton [2013] STC 866, this case refines the notion of discovery where a scheme similar to that implemented by a taxpayer is the subject of an appeal. According to the FTT, a discovery can only occur once the appeal is final.

Neil Patullo v HMRC [2014] UKFTT 841

Notice for security

Summary - The FTT upheld a notice for security.

The taxpayer appealed against a notice of requirement to provide security (VATA 1994 Sch 11 para 4(2)). Three companies had operated the Grange Restaurant business over a period of years and had failed to meet the business' VAT obligations. The appellant contended that the failure of the previous companies should have no bearing on HMRC's assessment of the risk to the public purse. The FTT disagreed, observing in particular that the fact that the business was managed from the same premises throughout outweighed the change in personnel. Furthermore, the risk was particularly tangible in a cash business, 'where the trader has the use of the VAT paid by the customers until such time as, and if, the trader pays the VAT to HMRC'.

Decision:

The FTT also found that the assessments issued by HMRC had not been appealed and were therefore final. The fact that no returns or business records (due to the taxpayer's non-compliance) had been submitted was now irrelevant. The assessments were the best evidence available. The FTT therefore accepted the quantum of the security, calculated as the equivalent of four months' liability.

Finally, the FTT noted that the appellant had a strong history of non-compliance with VAT obligations. Consequently, given the apparent understatement of the business turnover and the size of the business, there was a clear risk of loss of revenue.

Comments - Cases on notices for security are few and far between, yet this is a powerful tool in the hands of HMRC. The case is therefore a useful example of the practical considerations which come into play when assessing the validity of such a notice.

Grange Restaurants v HMRC [2014] UKFTT 832

Section 54 agreement and duress

Summary - The FTT granted HMRC an application to strike out appeals on the ground that they had been settled by agreement under TMA 1970 s 54.

The FTT observed that if the appeals had been settled under a s 54 agreement, they would be treated as if they had been judicially determined so that, under the principle of res judicata, the FTT would have no jurisdiction. The two taxpayers contended that no s 54 agreement had been entered into, as they had not been aware that HMRC had made an offer, the terms of which were unclear in any event, and they had made their payments under duress.

The FTT found that the taxpayers must have been aware of the offer as they had made a counter-offer — which was rejected. Furthermore, Mr Thompson had eventually agreed to the amended return. As for the duress agreement, the FTT noted that the purpose of s 54 agreements was to achieve finality for both sides. The taxpayers were therefore faced with a heavy burden.

The fact that they openly disagreed with the outcome did not mean that they were not bound by the agreement. In the absence of cogent evidence of undue pressure, the FTT was not prepared to challenge its existence. Similarly, a subsequent email sent by Mr Thompson, suggesting that he may want a tribunal hearing, did not amount to a repudiation of the agreement in the absence of express terms to that effect.

Finally, the FTT rejected arguments that the taxpayers had entered into the agreement as a result of being misinformed by HMRC as to the costs of a hearing.

Comments - The case suggests that a taxpayer wishing to challenge the validity of a s 54 agreement on the grounds of duress or misrepresentation will be faced with a tall order. This is because the very purpose of such an agreement is to achieve finality for both parties.

Thompson and Skinner v HMRC [2014] UKFTT 826

Closure notices and discovery assessments

Summary - The FTT held that the requirements for a discovery were satisfied.

The taxpayer contended that the requirement (in TMA 1970 s 29(1)) for a discovery was not satisfied, as enquiries (under TMA 1970 s 9A) had been opened into the relevant returns and PAYE enquiries (under the Income Tax (PAYE) Regulations, SI 2003/2682, reg 72(5)) had confirmed the taxpayer's liability. Closure notices had duly been issued and HMRC had subsequently issued discovery assessments in respect of income tax not included in the closure notices.

Decision:

The FTT referred to Corbally-Stourton [2008] UKSpC00692 as authority for the proposition that there can be both a closure notice and a discovery assessment. The FTT added that there had been full disclosure neither in the tax returns, nor during the enquiry, and that there had been no cooperation with HMRC. Referring to Hankinson [2011] EWCA Civ 1566, the FTT pointed out that the purpose of s 29 is to protect the taxpayer who has made a full disclosure; that was not the case in this instance.

The FTT explained that as a result of a direction notice issued under reg 72(5), the liability of the taxpayer's employer had passed to the taxpayer. However, the taxpayer had not appealed the direction notice or the closure notice. HMRC had therefore been right to wait until the expiry of the appeal period to issue the discovery assessments, which were the only way of assessing the taxpayer's income. The amount of under-assessed income was only 'discovered' at that point.

Comments - This is a useful example of the interaction between enquiries and the issue of discovery assessments. It is also a reminder of the wide powers of HMRC in the realm of discovery. In this case, the discovery resulted from the mere fact that the taxpayer could no longer appeal and was therefore liable for the income tax which remained unpaid by his employer.

Michael S K Yip v HMRC [2014] UKFTT 865

Information notice in relation to bank statements

Summary - the FTT found that an information notice was reasonably requested.

HMRC had opened an enquiry into the appellant's self-assessment return and requested UK bank statements. The appellant's advisers had replied that no case had been made for requiring the bank statements. HMRC then explained that they had information suggesting that the appellant had received interest, which had not been declared in his return.

A certificate showing an interest receipt of £19,956 was provided. The appellant apologised for not including the interest in his return, explaining that all the documents had been stolen during a robbery of his apartment in Switzerland.

HMRC then requested statements for the account, on the basis that the interest suggested a large amount held on deposit. Such statements were not provided and HMRC eventually issued an information notice (FA 2008 Sch 36 para 1). Mr Mawji appealed against the notice.

Decision:

The FTT observed that if the source of the remitted funds was overseas income which had not been taxed in the UK, then the funds became taxable when remitted to the UK. It was therefore important for HMRC to know whether the overseas account from which the funds had been remitted to the UK had earned interest. The FTT also noted that the appellant had given contradictory statements on the provenance of the funds. The FTT added that the bank statements were still in the appellant's power, regardless of the fact that he no longer had them; he could ask his bank to produce them. Furthermore, the six year time limit did not apply, as the notice had been given by an authorised officer (Sch 36 para 20). Finally, the fact that the requested statements would lead to further requests and therefore more 'trouble' for the appellant was not a relevant consideration. The FTT concluded that the information was 'reasonably required' by HMRC.

Comments - This is a useful example of the way the FTT will approach an appeal against an information notice. The FTT went to the substantive issues to ascertain the reasons why HMRC needed the information, as well as more procedural issues; the lack of cooperation of the taxpayer.

Karim Mawji v HMRC [2014] UKFTT 899

Jurisdiction of the FTT and legitimate expectation

Summary - The FTT held that it did not have jurisdiction to hear a claim based on legitimate expectation.

Ms Gore ran a business providing a children's indoor playcentre. Her husband had been told by the VAT helpline that no VAT was due on the entrance fees. She therefore had stopped charging VAT on those.

As a result of an audit, HMRC realised that VAT should have been accounted for and assessed accordingly. Ms Gore appealed, on the ground that she had acted in reliance on advice given by HMRC.

The issue was therefore whether the FTT has jurisdiction to consider a taxpayer's claim based on the public law concept of legitimate expectation.

Decision:

The FTT observed that the appellant's arguments would remove much of the distinction between the jurisdiction of the tax tribunals and that of the administrative court. Clear words would be required for that purpose and they were not included in VATA 1994 s 83(1)(p). The jurisdiction of the tax tribunals is limited to whether the assessment is correct as a matter of law, including whether it is made to best judgment.

Comments - The FTT clearly had some sympathy for the appellant. Whilst it suggested that judicial review was the best remedy, it also recommended approaching the adjudicator or the Parliamentary ombudsman. However, the FTT felt bound by case law, and in particular Abdul Noor [2013] UKUT 071, to find against the appellant.

Clare Gore v HMRC [2014] UKFTT 904

Information needed on tax return

Summary – The tribunal found the taxpayer had not complied with her obligations until the tax return was submitted even though a form R40 had been submitted.

The taxpayer was a company director and received dividends of £35,466 in 2011/12. She submitted a form R40 in July 2013 claiming a repayment of about £10,000. On 6 August, HMRC sent her a 2011/12 tax return, the deadline for completion being 13 November. The taxpayer filed her tax return online on 29 November. HMRC imposed a late filing penalty.

The taxpayer appealed, stating she had submitted the R40 voluntarily and was due a repayment. The information on the tax return did not change the position because it confirmed the information already held by HMRC.

HMRC refused the appeal.

Decision:

The First-tier Tribunal agreed with HMRC that the taxpayer's failure to file the return by the due date could not be excused by the fact that the information in the return was already in HMRC's possession. The taxpayer's tax liability for the year could not be established until the return was received. The judge said it was unreasonable for her to believe that she had complied with her tax obligations because a repayment claim had been submitted.

The taxpayer's appeal was dismissed.

Comments – This case demonstrates how the law can appear completely illogical to a taxpayer. HMRC had certain information but as the judge pointed out the taxpayer's tax liability for the year could not be established until the return was received. Therefore it was unreasonable for her to believe that she had complied with her tax obligations because a repayment claim had been submitted.

F Fisher v HMRC TC3930

Confused taxpayer

Summary – The tribunal found that a repayment was not due as the tax had probably not been paid in a case where the taxpayer was completely confused by the system of United Kingdom tax

The taxpayer moved to the UK from South Africa in 2006. He was not au fait with the UK tax system and his situation became very confused. He filed a 2006/07 tax return in February 2008, but two years later tried to sort out his tax by filing a return for a four-year period to 5 April 2010.

He claimed a repayment of tax for 2006/07. This related to employment with a security company, W, where he had been initially taken on as an employee. The taxpayer took W to the employment tribunal because it owed him £18,000 salary. Although judgment was given in his favour, W did not pay the outstanding amount.

Regardless of that, the taxpayer included the £18,000 in his tax return and claimed repayment of tax. HMRC refused the claim.

Decision:

The First-tier Tribunal said there was no evidence that the taxpayer had been paid the £18,000 or paid the appropriate tax. He could not be repaid tax that had not been paid.

A second issue under appeal concerned 2008/09. The taxpayer had worked as an employee and an independent contractor through a company, and included various amounts of self-employment income and salary paid by his company on his return for the period. He then claimed on his self-assessment return a repayment of the corporation tax paid by his company. This HMRC repaid in error and subsequently reclaimed. The tribunal agreed that the amount should be repaid by the taxpayer.

The taxpayer's appeal was dismissed. It is worth noting that HMRC did not impose any penalties because they accepted that the errors had arisen from confusion.

Comments – Although as tax practitioners we sometimes struggle with the complexities that the law has built into the system this case demonstrates how taxpayers can be completely confused by the whole system and how it works. It demonstrates that a system based upon self-assessment of income and the liabilities can often be “a bridge too far”. Luckily because of the confusion the taxpayer did not end up with penalties.

J Partridge v HMRC TC3946

Reasonable enquiry

Summary – The Tribunal found that HMRC's raising of an enquiry was reasonable after the procedures following the identification of an understatement

HMRC enquired into the company's 2010/11 tax return and concluded that it had understated its profits for the year. The officer issued a closure notice amending the return. He also issued a discovery assessment for 2011/12, on the presumption that the company had understated its profits in the same way. He could have opened an enquiry into the 2011/12 return, but chose instead to issue the discovery assessment under FA 1998, Sch 18 para 43.

The company appealed against the amendment to the 2010/11 return and the discovery assessment. An internal review concluded that the assessment should be withdrawn but the amendment should stand. Shortly afterwards, HMRC opened an enquiry into the 2011/12 return. The company applied to the First-tier Tribunal for a closure notice, arguing that it had legitimate expectation that, because the discovery assessment had been withdrawn, HMRC had not grounds to begin an enquiry into that year's return.

Decision:

The tribunal said the reviewer had decided the assessment should be withdrawn because a presumption of continuity could not justify the additional assessment. This should not lead "a reasonable man" to conclude that the reviewer had agreed that the company's reported profit was correct. It was understandable that HMRC wished to investigate further as to whether there was an understatement.

The taxpayer's appeal was dismissed.

Comments – The Tribunal's decision was logically following the pattern of the events in this case.

Easinghall v HMRC TC3800

Confusion over penalties or interest with employer's returns and PAYE

Summary – The Tribunal found that the penalties charged were correct and that the taxpayer had no reasonable excuse for the late filing of her return

The taxpayer was late filing the 2011/12 employer return. HMRC imposed penalties of £1,200, which they mitigated to £559, this being PAYE due on the return which she filed online on 1 July 2013.

Not realising that the penalties related to the late return, the taxpayer appealed on the basis that she had paid the tax on time. She claimed that she had spoken to HMRC several times and had not been told that they were in respect of the return. Not until February 2014 did HMRC write explaining the position so that the taxpayer understood the basis of the penalties.

Decision:

The First-tier Tribunal found that the penalties charged to October 2012 were correct and that the taxpayer had no reasonable excuse for the late filing of her return. However, the judge said for the remainder of the default period, HMRC had contributed to the taxpayer's “continuing misapprehension that the penalties related to PAYE”. He therefore quashed the second and third penalties.

The taxpayer's appeal was allowed in part.

Comments – The imposition of penalties needs to be clearly understood. The taxpayer had not understood the system hence the wrong application. However it was clear to the judge that HMRC had contributed to the confusion or at least not helped and accordingly applied leniency.

L Awdry v HMRC TC3908

Communications from HMRC made no sense

Summary – The Tribunal held that a late filing penalty was not due to an incompetent communication from HMRC

The taxpayer appealed against a late filing penalty in respect of his 2012/13 return. He said HMRC had not asked him to complete a return, but that he would do so if they sent him the form. HMRC said they had sent him a notice to file. On 20 March 2014, they rejected his appeal saying: “I see that no evidence to date has been received confirming that you did not receive a tax return or notice to file.” Describing this statement as “tautology”, the taxpayer appealed to the First-tier Tribunal.

Decision:

The tribunal said HMRC's letter of 20 March was “a piece of nonsense” and that it was “ridiculous to expect the appellant to produce evidence to show he did not receive the tax return or notice to file”. The presiding member noted that the taxpayer had filed returns previously but not every year, so there was no reason why the fact that he did not receive a request to file one for 2012/13 should alert him to a problem.

On HMRC's assertion that they had sent him a notice to file, the tribunal accepted the taxpayer's claim that he had not received this and suggested that this may have been because HMRC had addressed it inaccurately. The tribunal concluded that he had a reasonable excuse for not filing a return.

The taxpayer's appeal was allowed.

Comments – It beggars belief that HMRC allowed this case to get the Tribunal. The letter was clearly nonsense and was asking a taxpayer to prove a negative. In the real world this is very difficult and in the tax world this was obviously impossible. The judge had no choice but to find in favour of the taxpayer.

S South v HMRC TC3924

Extended delay

Summary – The Tribunal confirmed the penalty in respect of a late filed employer's return

The taxpayer, a small playgroup managed by volunteers, was late filing its 2010/11 employer return. HMRC imposed penalties, against which the playgroup appealed on the ground that payment would cause hardship to the group. The return was submitted late because there was a change in the committee and the person who left did not forward correspondence to the group. The playgroup rectified the error as soon as it could.

Decision:

The First-tier Tribunal decided the playgroup did not have reasonable excuse. It noted that the returns for 2011/12 and 2012/13 had been filed in time and should have alerted the taxpayer to the fact the 2010/11 return was outstanding. Every employer should know that "certain formalities have to be observed including making returns to HMRC".

The penalty was confirmed and the taxpayer's appeal dismissed.

Comments – The case is self-explanatory and demonstrates the need to ensure returns are filed at the appropriate time and records kept thereof.

Hambleton Playgroup v HMRC TC3932

Condition for 'special relief'

Summary - The FTT found that the conditions for 'special relief' against a determination by HMRC were not satisfied.

Mr Currie had failed to submit his self-assessment returns for the years 2005/06, 2006/07 and 2007/08. At the time the returns were eventually filed, Mr Currie was out of time to displace determinations issued by HMRC. He claimed 'special relief' under TMA 1970 Sch 1AB para 3A. 'Special relief' applies where it would be 'unconscionable' 'in the opinion of the Commissioners' for HMRC to recover the relevant amount.

Decision:

Firstly, the FTT had to decide whether its jurisdiction was limited to deciding whether HMRC's opinion that para 3A did not apply was unreasonable or whether it could decide whether the 'unconscionable' condition was satisfied. Referring in particular to John Dee [1995] STC 941 and Pegasus Birds [1999] STC 95, the FTT found that 'in the opinion of the commissioners' was a statutory condition, limiting its jurisdiction to considering whether the opinion of the Commissioners was unreasonable. In this case, the opinion of the review officer was the issue and the FTT noted that he had to take into account all relevant information provided by the claimant.

Mr Currie contended that he had relied on his accountants and had had no direct contact with HMRC, however evidence pointed to the contrary. In any event, the FTT observed that reliance on a third party is rarely a reasonable excuse, so it is unlikely to meet the higher hurdle of 'unconscionability'. Similarly, the fact that enforcement of the determination may lead to the taxpayer's bankruptcy did not make it unconscionable.

Comments - Taxpayers rarely claim 'special relief', for which the hurdle is even higher than reasonable excuse. The case is therefore a useful example of the way the FTT will approach a claim for 'special relief'.

Donald Fitzroy Currie v HMRC [2014] UKFTT 882

HMRC News

Gift aid on donations that attract a right of free admission to charity property

HMRC has updated its guidance for charities to explain that the terms and conditions attached to a donation that gives a right of admission to property cannot include a right to a full or partial refund of the admission payment.

Withdrawal of paper EMI1

The paper version of form EMI1 is no longer available.

Updated PAYE penalties and appeals helpsheet

HMRC has updated this helpsheet following the announcement of the phasing in of in-year PAYE filing penalties for 2014-15. This can be found at http://www.hmrc.gov.uk/news/paye-late-pen.pdf

Pensions schemes newsletter 65

October submission of

1. RPSCOM100(Z)
2. Transition of Pension Schemes Services (PSS) web content to GOV.UK
3. Fit and proper person rules for pension scheme administrators
4. Individual Protection 2014 (IP2014)
5. Pension Statements and the annual allowance
6. PS helpline automated service

List of changes made to HM Revenue and Customs FATCA guidance published

HMRC has published a list and description of the material changes made to the HMRC Foreign Account Tax Compliance Act (FATCA) guidance in the August update.

Short Term Business Visitors

The wording of the agreement has been updated. Existing users should use the new version without signing new agreements.

Auto-enrolment: assessing and categorising staff **(Lecture P858 – 10.23 minutes)**

Definition of worker

For the purposes of assessing the workforce for auto enrolment, the term 'worker' is someone who works under a contract of employment (an employee) or has a contract to perform work or services personally and are not undertaking the work as part of their own business.

The detailed technical guidance in this area is the A4 (28 pages) guide 1 – Employer duties and defining the workforce.

http://www.thepensionsregulator.gov.uk/docs/detailed-guidance-1.pdf

Agency staff

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

Personal service workers

As can be seen from the definition above, it is possible for workers to fall under auto enrolment even if they are not formally an employee. The guidance indicates that employers should not rely absolutely on a worker's tax status to determine the question of whether they are responsible for auto enrolment in relation to the individual.

The detailed technical guidance provides the following factors to consider when deciding whether less formal arrangements with individuals come within auto enrolment responsibilities.

"No single factor, by itself, is capable of being conclusive in determining whether a contract is 'for services' or 'of service'. However, individuals are likely to be considered as personal service workers (workers under the contract of services) if most, or all, of the following statements are true:

- The employer relies on the individual's expertise and expects them to perform the work themselves
- There is an element of subordination between the employer and individual, for example the individual reports to the employer's managers or directors in respect of the specific operation or project on which they are contracted to work

- The contractual provisions state that the contract is not a contract for services between the employer and the individual's own business

- The contract provides for employee benefits such as holiday pay, sick pay, notice, fees, expenses etc.

- There is a mutual obligation set down in the contract to provide or do the work

- The individual does not incur any financial risk in carrying out the work

- The employer provides tools and equipment to the individual to carry out the work.

This list is not exhaustive. As when they are assessing an individual's status for tax purposes, an employer must take into account all relevant considerations."

Secondees

Individuals working on secondment from another company will usually remain a worker for the company from which they are seconded. Therefore, an employer with a secondee is unlikely to have any employer duties in relation to that individual, but the employer who has seconded their worker usually will. However, employers should examine the contractual and remuneration arrangements for secondees to ensure the correct party carries out the employer duties.

One-person companies

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

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

Office-holders

An office-holder is not normally a worker. An office-holder has no contract or service agreement in relation to their appointment, nor do they usually receive a salary or regular remuneration for their services. They may however, be paid a fee for their services or to cover their expenses.

Examples of office-holders who are not normally workers include:

- non-executive directors
- company secretaries
- board members of statutory bodies
- trustees.

It is very important to consider the specific circumstances of the individual. Sometimes a person who appears to be an office-holder may also have a contract of service for part of their duties and will therefore be a worker in respect of those duties.

Volunteers

Volunteers would not normally have a contract of service and are not workers. However, this may change if any form of payment or non-financial benefit is given to them.

Three types of worker

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

The income calculations are dealt with later as these form part of the more detailed planning which comes later. At this point the employer is just assessing broadly how many staff he has in each category, so that they have a clear idea of whether they will need an auto enrolment scheme or not, and how many staff are likely to be members. This will enable the employer to plan with an adviser what is the most appropriate scheme for his workforce.

The key criteria

Whether a worker must be enrolled in an auto enrolment scheme, or may opt in or join a scheme is determined by three criteria:

1. The worker's age
2. Whether the worker is working (or ordinarily works) in the UK under their contract, and
3. Whether qualifying earnings are payable in the relevant pay reference period.

It is assumed for the purpose of the remainder of this session that all workers qualify under the UK working rule, but there is more information linked below regarding two special categories of worker.

Staff who must be auto enrolled

There are two qualifiers for staff to be within auto enrolment:

1. The worker is aged between 22 and state pension age, and
2. The worker has annual earnings in excess of £10,000

If the answer to both is yes, the employer will have to automatically enrol them into a pension scheme and make contributions towards it. These staff are known as eligible jobholders.

Other staff (see also table below)

- Staff aged 16 to 74, earning over £5,772 (= LEL) up to and including £10,000 a year have the right to opt in to the automatic enrolment pension scheme. This is a similar process to automatic enrolment, and the employer will have to contribute to their pension. These staff are referred to as non-eligible jobholders.

- Those aged 16 to 74 who earn £5,772 a year or less have the right to join a pension scheme. They can only join after the staging date. These staff are referred to as entitled workers.

- Staff aged under 22 earning above £10,000

- Staff aged 16 to 21 who earn more than £10,000 have a right to opt in to the automatic enrolment pension scheme, and are also non eligible jobholders. Again, the employer will have to contribute to their pension if they decide to opt in.

Summary Table

Annual earnings (2014-2015)	Age		
	16-21	22-state pension age	State pension age -74
Less than £5,772	Has a right to join a pension scheme (referred to as “entitled worker”)		
£5,773 to £10,000	Has a right to opt in (referred to as a “non-eligible jobholder”)		
Over £10,000	Has a right to opt in	Automatically enrol*	Has a right to opt in

* Referred to as an eligible jobholder

When to assess your workers

Workers must be assessed at various points in the run up to and during auto enrolment. More guidance is provided in the Pensions Regulator detailed guidance #3, entitled “Assessing the workforce”. (58 pages)

http://www.thepensionsregulator.gov.uk/docs/detailed-guidance-3.pdf

The dates on which a worker must be assessed are the:

- employer's staging date, for a worker already in employment on that date
- first day of employment, for a worker who starts employment after the employer's staging date
- date of the worker's 22nd birthday, where this occurs after the employer's staging date
- date of the worker's 16th birthday, where this occurs after the employer's staging date
- date they receive an opt-in or joining notice from a worker
- deferral date, if an employer has chosen to use the postponement provision for a worker
- day after the transitional period has ended, if an employer has chosen to use the transitional period for defined benefit
- first day of each pay reference period, where the first assessment identifies the worker to be a non-eligible jobholder or entitled worker.

For a non-eligible jobholder or entitled worker, an employer will need to continue to assess the worker in order to identify a change to eligible jobholder status. So a further assessment date is the first day of any pay reference period.

The employer must make the assessment based on the worker's circumstances on the assessment date. The employer may be able to carry out the assessment ahead of time, if they are confident the circumstances will not change. Similarly, it may be possible to make the assessment after the assessment date and look back to what the criteria was on the assessment date. However, an employer should be aware that if they choose to do it this way, they will reduce the amount of time available to them to complete automatic enrolment or provide information, as there are set time limits within which the employer duties must be complied with.

UK workers

In essence this should be fairly simple to do. The detailed guidance provides a little more advice regarding:

- Offshore employments (oil and gas installations and similar), and
- Seafarers.

See http://www.thepensionsregulator.gov.uk/docs/detailed-guidance-3.pdf at page 13. There is more help on determining UK workers from that page onwards, together with some examples.

Assessing the age of workers

Some clients will have the software available to assess worker's ages. All staff aged between 16 and 74 will potentially be affected by auto enrolment, as they can be either in the jobholder categories (eligible and non-eligible) or entitled worker category. Their remaining entitlement under auto enrolment will be determined by their rate of pay.

Assessing whether qualifying earnings are payable

Guidance on this aspect of assessing the workforce starts on page 20 of the detailed guidance booklet (#3) referred to above.

For many workers, the assessment will be straightforward, for example workers who are paid a regular, non-fluctuating amount in each pay reference period. However, for workers whose earnings fluctuate, the earnings assessment will be less straightforward. In this case, on the assessment date, the employer will have to complete the following steps:

Step A: Identify the relevant pay reference period.

Step B: Identify what is payable in that period.

Step C: Compare what is payable with the lower level of qualifying earnings and the earnings trigger for automatic enrolment.

Identify the pay reference period

There are two definitions of the pay reference period in the legislation, and employers staging after November 2013 are permitted to choose which of these suits them best. The two options are a pay reference period aligned to:

- tax weeks or months, or
- periods in respect of which the worker is actually paid

It is acceptable to choose one definition of a pay reference period in respect of some workers, and a different one for others. One reason to align to tax weeks or months is that the thresholds change in line with each tax year, and this avoids having a split pay reference period with two limits being time apportioned. Clearly, this is only of concern when workers are near one of the limits.

However, when a worker is taken on for less than a week, there is no tax pay reference period, so the pay reference period for which payment is made is the only option for the employer to use.

The length of the pay reference is the longer of a period:

- equal in length to the usual interval between payments of the person's regular wage or salary, or
- of one week

So the minimum pay reference period is a week, when workers are paid weekly or more frequently.

The employer then takes pay reference periods of the defined length, with the first pay reference period in any tax year starting on 6 April. (the start of the tax year therefore re-sets the pay reference periods for this purpose).

A worker's pay reference period is:

- one week, in the case of a worker who is paid their regular wage or salary by reference to a period of a week, or
- in the case of a worker who is paid their regular wage or salary by reference to a period longer than a week, whichever period the worker is paid by reference to.

For example, for a person paid by reference to a monthly period, the pay reference period will be one month.

The usual pay reference period for a worker therefore is the period of time by reference to which the employer pays the worker their regular wage or salary. The pay reference period is not the interval between the dates the worker actually receives their pay, i.e. it is not the pay frequency, although sometimes the two will coincide. For example, a salaried worker who is paid by reference to the work done in a calendar month will have a monthly pay reference period and will also have a monthly pay frequency.

The relevant pay reference period

The pay reference period used for the assessment is the pay reference period in which the assessment date falls. This applies whichever definition the employer is using for the pay reference period.

Identify what is payable in that period

The employer is identifying whether qualifying earnings are payable in the pay reference period. The definition of qualifying earnings is an amount (in annual terms) of between LEL and UEL – that is £5,772 and £41,865 for the current tax year.

It is essential that the amounts payable are assessed against the limits, even if they are paid in respect of other periods. For example, if an annual bonus is paid with March salaries, and the date on which the bonus is payable falls in the pay reference period, then this amount is included in the assessment, irrespective of the fact that it relates to an annual amount of earnings.

The following components of pay are taken into account:

- Salary
- Wages
- Commission
- Bonuses
- Overtime
- Statutory sick pay
- Statutory maternity pay
- Ordinary or additional statutory paternity pay
- Statutory adoption pay.

Compare what is payable with the lower level of qualifying earnings and the earnings trigger for automatic enrolment.

Having identified the earnings payable during the pay reference period, these are then compared to the limits for auto enrolment. The employer is identifying any workers who are below LEL – they are not affected by auto enrolment.

For a worker aged between 22 and state pension age, the employer must identify whether the qualifying earnings payable are:

- above the earnings trigger for automatic enrolment, or
- between the lower level of qualifying earnings and the earnings trigger for automatic enrolment.

For all other workers, the employer must compare the qualifying earnings payable with the lower level of qualifying earnings.

Pay reference period	Lower level of qualifying earnings (LEL) £	The earnings trigger for automatic enrolment (PA) £
One week	111.00	192.00
Fortnight	222.00	384.00
Four weeks	444.00	768.00
One month	481.00	833.00
One quarter	1,443.00	2,499.00
Bi-annual	2,886.00	4,998.00
Annual	5,772.00	10,000.00

Earnings between the limits means that the individual is a non-eligible jobholder. To be an eligible jobholder the individual must be paid above the earnings trigger indicated above.

Key action points

Identify any additional workers to be considered for auto enrolment, including fixed salary partners and self-employed consultants. Inform your client of the outcome.

Discuss with each client the desired definitions of pay reference period and start assessing staff.

The earnings trigger for auto enrolment on or after 6 April 2015 will be £10,500 annual amount. The LEL for next tax year will be announced in November 2014. You can make broad assessments early to give an indication.

Identify with clients how workers crossing the relevant age brackets and needing re-assessment will be identified.

Review how the earnings assessment which is ongoing may need to be applied for workers who are not currently within auto enrolment. Note that this applies to every pay reference period. Review the basis of payment of bonuses etc. to consider whether these might be paid more frequently, and the use of postponement to provide time to consider the appropriate action, such as paying bonuses more regularly. This will only be relevant for lower paid staff for whom the bonus tops them up above £10,000 on an annual basis for one pay reference period.

Contributed by Rebecca Benneyworth

Auto-enrolment: Assessing pensions /choosing a provider (Lecture P859 – 7.09 minutes)

Existing schemes

If the employer has an existing pension arrangement, it must be reviewed to ensure that it is auto enrolment compliant.

An auto enrolment scheme must meet three types of criteria :

- The automatic enrolment criteria,
- The qualifying criteria, and
- The minimum requirements.

Firms with no financial advisory or pension's expertise should be very wary of confirming that existing defined benefit schemes do comply, and it is likely that if a client has a defined benefit pension arrangement in place already that you will wish for a financial adviser to undertake this work. Those IFA's who charge an hourly rate are more likely to be willing to accept the undertaking. Existing pensions providers may also be able to confirm whether the scheme meets auto enrolment requirements.

Note that, similar to selecting an appropriate scheme, advice about whether a scheme qualifies or not is not regulated investment advice when provided to a client employer.

When the scheme is defined contribution (also referred to as money purchase) this is a much simpler task, and the Pensions Regulator provides an online tool to test whether the scheme complies or not.

This area is covered in the detailed guidance booklet #4 Pension schemes. The appendices to the booklet take you through a step by step approach which can be used to assess existing Defined Benefit (Appendix C) and Defined Contributions (Appendix D) schemes.

Pensions regulator – qualifying scheme tool

There is a simple online tool which allows employers to check whether their existing defined contribution (money purchase) scheme meets the conditions required for an auto enrolment scheme. This can be accessed at http://www.thepensionsregulator.gov.uk/employers/does-your-existing-scheme-qualify.aspx

Choose a scheme and provider

Previous sessions on this subject have identified the issues in giving advice at this point. An overview of the advice provided by the Pensions Regulator to employers is covered here, but no more detailed financial considerations will be considered.

Trust based schemes

The pension regulator's advice is that trust based schemes are probably not cost effective for less than 1,000 employees.

Questions to ask providers

Questions you should ask about the legal requirements include:

- Does the scheme allow at least the minimum contribution levels?
- Does the scheme allow staff to join it without providing any information?
- Does the scheme allow staff to join it without making any choices, e.g. about where their money is invested?

Questions you should ask about the quality of the scheme include:

- Do you ensure that the investments on offer are appropriate now and in the future?
- Will you regularly review costs and charges to ensure they are still value for money?
- Is compensation available if anything goes wrong?
- Are members' options clearly communicated as they approach retirement?

There is also an information booklet for employers entitled "A quick guide to selecting a good quality pension scheme for automatic enrolment". (10 pages)

http://www.thepensionsregulator.gov.uk/docs/employer-select-pension-automatic-enrolment.pdf

The appendix to this booklet includes a much more detailed list of questions that the employer might use in assessing whether a scheme is suitable for his needs or not.

Guidance aimed at accountants

The Pensions Regulator has produced a short guide for accountants to use when dealing with questions from clients about choosing a pensions scheme / provider for auto enrolment. It is called Pension Scheme selection and automatic enrolment (7 pages) and is at http://www.thepensionsregulator.gov.uk/docs/accountant-select-pension-automatic-enrolment.pdf

The Appendix to the document sets out the characteristics of a good quality scheme.

Key area	Considerations
Scheme simplicity	Workers' interest in, and understanding of, their pension savings is often very limited. It's important that the pension scheme reflects that possibility
Investment options	Each investment option should suit a certain type of member Too much choice can be confusing for members. So the pension provider will need to be able to explain why each core investment option – in addition to the default option – is appropriate to the needs of the workers now or in the future The default investment strategy must be appropriate because it's likely that a large proportion of the workers will end up using it
Managing investments	Members must be able to understand where their money is being invested and what risk that carries
Value for money	The costs and charges taken from members' savings should be competitive when considered against the benefits and services that those members receive It should be clear what members are getting for their money, how much it costs and, importantly, whether they actually need any extra services provided
The pension provider	The individuals or organisations that run the scheme must have the requisite skills, knowledge and processes to carry out their role effectively Pension providers must be able to demonstrate how they ensure that the needs of scheme members are taken into consideration when they make commercial decisions The pension scheme's records must be accurate and up to date at all times to ensure that members can be contacted and that they are receiving the right information to monitor their savings The complaints process should be clear so that members understand how to make a complaint should problems occur Protections should be in place in the event of the pension provider entering difficulties The pension provider retains ultimate accountability for the work that is done on their behalf by third parties. This should be made clear
Communications	Good quality communications should be regularly sent to the members of the scheme which explain their situation in a fashion which is easily understood When a member retires, they should receive information about how to turn their retirement savings into an income, including the open-market option

Setting up the scheme

There are various steps needed to set up the scheme and make it active, and the amount of time needed for each will vary according to the type of scheme, the scheme provider needs and the number of worker affected. In broad terms the following areas will need consideration.

Agree contribution rates

The minimum contributions for automatic enrolment, including the minimum that the employer must pay, are set out in law, and the scheme chosen must adhere to these as a minimum. However, each scheme may set its own contribution rates for the employer and staff member, so the employer will need to agree these with the provider when setting it up.

Agree due dates for payment of contributions

If staff members have to pay contributions to the pension scheme, the employer must deduct those contributions from their pay. The law states that after the contributions have been deducted, the employer must pay them across to the scheme within certain time limits.

The scheme provider will tell you what the limits are. The employer and provider should agree a convenient due date for contributions to be paid to the scheme that falls within the statutory time limits

Tax relief on employee contributions

Staff will be entitled to tax relief on their contributions. Some pension schemes require the employer to deduct pension contributions from their staff member's gross pay and others from net pay (after PAYE tax has been deducted). The employer will need to check with the provider how they handle tax relief.

Find out what the provider needs and when to create membership

The provider will need certain information from the employer about the staff automatically enrolling so they can set up membership of the scheme for these staff.

The employer will therefore need to find out exactly what information is needed and when. As a minimum, the staff member's name, postal address, date of birth and National Insurance number will be required.

The employer will also need to find out how long it takes them to create active membership for staff after the provider has all of the standing data. If the employer is auto enrolling a lot of staff at the same time at either staging or after postponement, it may take the provider longer than usual to make all of them active members. Check with the provider.

Establish how the provider manages opt outs

Staff who have been automatically enrolled have six weeks during which they can choose to opt out. They do this by giving the employer an opt-out notice, which they get from the scheme provider. If they opt out, the staff member will be removed from the scheme and will get a refund of any contributions they have paid.

The employer will therefore need to establish:

- how the staff member obtains the opt-out notice from the provider
- whether the provider offers an online service that staff can use to opt out
- if the provider can handle opt-out requests on the employer's behalf, how the employer will be notified of a staff member's choice to opt out
- how quickly the provider processes any requests to opt out and, refunds any contributions already paid to the scheme. (these are normally refunded to the employer who must pass on the employee contributions promptly)

How the provider manages opt ins or joiners

Staff who are not eligible for automatic enrolment can ask to opt in to, or join, the pension scheme. The employer will need to find out what the provider needs and how quickly they create membership for these staff.

Timing

The action plan indicates that work in this area should start at around 11 months before staging.

Key points

Decide with your clients and within your firm the extent to which you will be involved in helping clients to check existing schemes or choose a scheme provider for auto enrolment

Ensure that you have the necessary skills if you are to provide financial advice and check your insurance position

Carry out research about those providers who will accept business from very small schemes so that you have at least a list of appropriate contacts for clients who wish to make the decision themselves.

This work needs to start well in advance of auto enrolment staging dates. Most providers regard 6 months as the absolute minimum to set up the scheme in readiness for AE staging dates.

Contributed by Rebecca Benneyworth

Auto – enrolment: Communicate to staff (Lecture P860 – 7.16 minutes)

Raising awareness

The employer should start raising awareness about auto enrolment early in the preparatory phase, so that when the specific factual communications are issued, employees are already primed on the basics.

The Pensions Regulator has made a variety of information and other resources available which can be adapted and used at this point. Suggestions on the website include ideas for text messages, online articles, workplace posters and similar. The broad theme of this is to encourage employees to view saving for a pension as an important step, so that when auto enrolment staging arrives, employees understand the importance of the opportunity that is presented.

There are also FAQ booklets which can be used to advise staff about auto enrolment and how it will affect them.

This general awareness raising stage is then moved on to more specific information in the run up to staging, followed by mandatory information given within six weeks of staging.

The pensions regulator page which sets out the awareness raising exercise is at http://www.thepensionsregulator.gov.uk/employers/raising-awareness-about-automatic-enrolment.aspx and this includes a number of resources and ideas for employers to use.

Direct communication to each worker

Employers must write to each member of staff telling them how automatic enrolment law affects them, for example, whether they have been automatically enrolled, or that automatic enrolment has been postponed for them. Employers must do this within certain time limits, usually within six weeks of them being enrolled, or within six weeks of the staging date if the employer is postponing.

You will need to support your client to start planning these communications before staging date, so they know who should receive what information.

There is a wide variety of letter templates on the Pensions Regulator website which will cover all of the required communications at this stage. As an external adviser, you will need to establish whether your client is happy to undertake this task or whether they will want you to provide the necessary support.

There are important statutory requirements for information to be given about specific issues at specific points in time. As much of this is done at the point of staging and auto enrolment, the detail of this appears in a later session of these seminars.

All off the requirements about statutory notices to staff are included in the detailed guidance for employers Booklet Number 10 which is 35 pages long, and can be found at http://www.thepensionsregulator.gov.uk/docs/detailed-guidance-10.pdf

Statutory information requirements

The information must be given by the employer to the worker in writing and before the end of a specified period. The different information requirements for an employer are:

- information to eligible jobholders and the trustees, managers or provider of pension schemes as part of the automatic enrolment, re-enrolment and enrolment process
- information to jobholders about the right to opt in to an automatic enrolment scheme
- information to entitled workers about the right to join a pension scheme
- information to jobholders who are active members of a qualifying scheme with that employer
- postponement notice, where an employer chooses to use postponement
- DB transitional period notice, where an employer chooses to use the transitional period for DB schemes and hybrid schemes with DB benefits.

Each of these has a range of statutory content which is dealt with in detail in the guidance booklet. There are also sample letters which deal with each situation.

The easiest summary of all of these requirements is in an online resource entitled "Information to workers". This includes links to all of the standard letters which support each stage. It is at http://www.thepensionsregulator.gov.uk/docs/resource-info-to-workers.pdf and is only 8 pages long.

Contributed by Rebecca Benneyworth

Follower and accelerated payment notices **(Lecture B857 – 16.29 minutes)**

The Government wanted to introduce these new notices as a result of the introduction of self-assessment for the self-employed and companies. Under self-assessment, the taxpayer tells HMRC what they believe their income to be and pay the tax due on that income. HMRC can challenge the amount of income declared through the Courts and if they win, collect the additional tax due but they have to wait for the final decision. They would prefer to have the tax up front and then for the taxpayer to appeal for a repayment. These new notices align the direct tax position with VAT, in that an appeal can only be made if the tax has been paid in full.

Follower Notices

Follower Notices will apply to all of the main taxes:

- Income tax
- Capital gains tax
- Inheritance tax
- Corporation tax
- Stamp duty land tax
- Annual tax on enveloped dwellings

Conditions for Follower Notice

The following conditions must apply:

A. There is a tax enquiry in progress into a return or claim, or an open appeal;

B. The claim or appeal asserts that a tax advantage arises from chosen arrangements;

C. HMRC claim there is a final judicial ruling relevant to the chosen arrangements; and

D. No previous Follower Notice has been given for these arrangements

Time limit

HMRC have 12 months after the later of:

- Judicial ruling in condition C above
- Day return received by HMRC/ appeal was made

What must be included?

HMRC must identify the judicial ruling on which their notice is based, explain why they believe that the ruling is relevant and include details of what the taxpayer must do next.

Representations

If the taxpayer wishes to make representations, they must do so within 90 days, stating that conditions A, B or D are not met. They can also argue that the judicial ruling is not relevant to the chosen arrangements or the Notice was given to late.

It is then up to HMRC to consider the representations and either confirm whether they are continuing or withdrawing the Notice.

What happens next?

HMRC will ask the taxpayer to amend their tax return and notify HMRC stating the amount of additional tax due and then pay the tax over.

If the taxpayer fails to amend their return, then HMRC will issue a second Notice charging the tax with an additional 50% added on top for not complying with the Follower Notice. This can be mitigated to 10% if the taxpayer decides to cooperate by amending their return!

The taxpayer can appeal to the penalty notice within 30 days if they have reasonable grounds.

Accelerated payment notices

These will apply when the following conditions are satisfied:

A. Tax enquiry is in progress into a return/ claim or there is an open appeal

B. The claim or appeal assert that a tax advantage arises from the chosen arrangements

C. One of the following is met:

- HMRC has issued a Follower Notice
- Chosen arrangements were previously notified under DOTAS
- GAAR counteraction notice has been issued

Representations

These can be made within 90 days stating that one of the conditions above is not met or the amount of tax is disputed. Once again, HMRC will consider the representations and either confirm whether they are continuing or withdrawing the Notice. Otherwise the taxpayer must pay the amount due and then appeal.

Effect of a notice on an open enquiry

The taxpayer must make their payment within 90 days or 30 days after the Notice is upheld or amended if later. There will be a 5% penalty at this point with further 5% penalties if still unpaid when 5 and 11 months late.

Effect of a notice – pending appeal

The notice prevents the relevant tax from being postponed pending the outcome of the appeal. HMRC obtains the tax upfront and does not have to repay it until such a time as the taxpayer wins their case.

Proposals going forward

Failure to pay over the tax, HMRC would be able to freeze your bank account and, after 14 days, take the amount of tax in the notice.

Business Taxation

Losses claimed out of time

Summary - The FTT found that it did not have jurisdiction to review HMRC's decision not to allow losses out of time.

Mr and Mrs Chauhan were appealing against HMRC's refusal to allow losses out of time. Their four months' delay were the result of computer difficulties.

Decision:

The FTT found that the Chauhans did not have a reasonable excuse. They earned over £50,000 between them and any reasonable businessman reliant on his computer would have made sure that it worked. A three year period of malfunction was unacceptable. In any event, following Steibelt [1999] BTC 184, the FTT found that it did not have jurisdiction with regard to HMRC's failure to exercise its discretion under CRCA 2005 and that the reasonable excuse defense would be of no assistance.

Comments - The taxpayers were only four months late; however, the persistent malfunction of their computer over a three year period was considered unreasonable.

Chauhan v HMRC [2014] UKFTT 851

AIA and 'qualifying persons'

Summary - The FTT held that an LLP made up of an individual and a company was not a 'qualifying person' for the purpose of the 100% annual investment allowance (AIA).

The appellant was an LLP whose partners were Dr Thorogood, a professional drilling engineer, and Thorogood Consultants, a company of which Mr Thorogood and his wife were directors. The LLP wished to claim the AIA on the upgrade of a plane used by Mr Thorogood. The question was whether the LLP was a 'qualifying person' under CAA 2001 s 38A and thus entitled to AIA. Section 38A provides that a 'qualifying person' is: an individual; a partnership of which all the members are individuals; or a company.

Drilling Global contended that it was a company for these purposes as a result of CTA 2009 s 1259, which requires mixed partnerships to be regarded as companies for the purpose of calculating corporation tax.

Decision:

The FTT observed that under the 'clear and unambiguous provisions of s 38A', the partnership was not a 'qualifying person'. It added that the provisions of the Income and Corporation Taxes Acts intended references to a partnership to include references to an LLP. Furthermore, if Parliament had intended an LLP to be treated like a company for the purpose of AIAs, it would have expressly provided for this.

Comments - Since their creation under UK law in 2000, the characterisation of LLPs for tax purposes has raised many difficulties. This case is a reminder that, although they are body corporates under the Limited Liability Partnerships Act 2000, they are, in the main, treated as partnerships for tax purposes.

Drilling Global Consultant v HMRC [2014] UKFTT 888

Capital allowance scheme failed

Summary - The UT found that an avoidance scheme using capital allowances did not work.

The issue was whether the partnership had incurred 'qualifying expenditure' within the meaning of CAA 2001 s 437 (expenditure on research and development relating to the partnership's trade). This raised two further questions: whether the partnership was trading; and, if so, what was the quantum of the expenditure.

Under a research agreement, the partnership had paid £193m to a company, Numology, in contemplation of a research sub-contract entered into between Numology and another company, PepTcell, which carried out the research for a payment of £14m.

Decision:

The UT accepted the FTT's finding that, although the evidence was not conclusive 'beyond all doubt', on the balance of probabilities the partnership's activities of funding and supervising PepTcell amounted to a trade. The UT added that the arrangements were commercial in nature, as their objective was the development of a vaccine which would yield royalties. Finally, the activities of the partnership went beyond that of a passive investor.

As for quantum, the UT noted that a 'factual enquiry' was required, by reference to a 'realistic approach of the facts'. Referring to Tower MCashback [2011] UKSC 19, the UT added that it may not be sufficient to look at what was paid to acquire the rights in order to ascertain the relievable expenditure.

A key issue was the circularity of funding: Numology's £86m contribution to the partnership was funded out of the £193m payable to it under the research agreement. The UT pointed out that circularity in itself did not preclude the conclusion that the partnership had expended the monies under the research agreement. However, the UT accepted the FTT's finding that Numology's contribution represented funds put into a 'loop' for tax avoidance purposes.

The UT also agreed with the finding that the partnership's expenditure in relation to the financing arrangement was to produce guaranteed licence fees for investors (the partners) and so was not 'on research'.

The UT concluded that only £14m constituted 'qualifying expenditure'.

Comments - The case applies principle derived from two very important decisions; Tower MCashback (supra) and BMBF [2005] 1 AC 684. Interestingly, the circularity of funds was not lethal to the scheme. It was the 'realistic' analysis of the purpose of the arrangements which proved fatal.

The Vaccine Research Limited Partnership and Mr Vaughan v HMRC [2014] UKUT 0389

Quantum of betting business takings

Summary - The FTT accepted the taxpayer's evidence on his business takings.

The taxpayer appealed against an assessment, which was based on HMRC's belief that his actual betting business takings were in excess of his declared takings. This was, in particular, due to the existence of blank betting slips and of unexplained deposits made into the taxpayer's personal account.

Decision:

However, the FTT was not convinced that blank betting slips were placed through the till and, in the absence of cameras, relied on the evidence of witnesses. Similarly, the FTT accepted the taxpayer's evidence that he paid his takings into his personal account to avoid bank charges. The FTT also accepted the taxpayer's claim that the substantial cash inflows into his personal bank account came from cash betting. The FTT observed that the taxpayer's refusal to provide his personal bank account records to HMRC was common among taxpayers; this was often the result of advice from professional advisers to the effect that personal records should not be produced in a business enquiry. Finally, the FTT accepted the taxpayer's evidence that he had been 'topping-up' the business account to avoid it becoming overdrawn.

Comments - Although appearances were clearly against the taxpayer, the FTT was prepared to look beyond HMRC's suspicions and to accept evidence submitted by the taxpayer.

Peter Devine v HMRC UKFTT 855

Proposals on the operation of the CIS

HMRC is consulting on proposals to improve the operation of the Construction Industry Scheme and the introduction of mandatory online CIS filing for contractors.

Qualifying conditions

Currently, subcontractors who meet certain qualifying conditions can apply to be paid gross with no deductions taken from their payments. There are two main tests: a turnover test and a compliance test

It is proposed that the threshold for the upper limit of the turnover test should be lowered to help more established businesses with multiple partners or directors qualify for gross payment status. The proposed new upper threshold could fall from £200,000 to £ 150,000, £120,000, or £100,000. The new threshold would also apply to closely held companies.

HMRC believes that for sole traders and the smallest partnerships and multi-director companies the minimum turnover threshold of £30,000 paid for construction activities per partner or director (excluding materials) remains appropriate to maintain the integrity of the scheme and ensure compliance with tax obligations.

To ensure that smaller businesses are not disadvantaged compared to larger ones HMRC proposes using fewer tests in the initial and annual review. The initial and annual tests for subcontractors who are also contractors will be restricted to a requirement to make monthly contractor returns, make timely payments of CIS deductions and to make an annual self-assessment return on time.

Mandatory CIS online filing

HMRC considers that many of the benefits of system improvements would only be fully realised if all CIS returns were made online. It is therefore proposing to remove the option to make monthly CIS returns on paper and to mandate online filing.

New CIS online appeals service

If a contractor fails to submit returns on time, HMRC charges penalties. To work alongside the new CIS online service, HMRC intends to adopt an automated system for processing CIS penalty appeals.

Taxpayers would be notified by an online messaging service in real time if their appeal was accepted immediately or referred for manual review. HMRC anticipate this process will replace the current paper based appeals service from the date of implementation. The paper based service will still be available for legacy penalties.

The nil return obligation - Change

Many of the penalties currently issued to contractors are for 'nil returns' where no payments to subcontractors have been made. In response to representation HMRC intends to remove the statutory obligation to report a nil return, removing the potential for a penalty to arise in these circumstances.

However when a return is not received by the filing date, HMRC systems will not know whether the reason is because the contractor is simply late filing the return or there is no return due. Therefore HMRC intends to operate a simple nil voluntary notification to enable contractors to notify HMRC if they did not pay subcontractors and this will stop a penalty notice being sent out. Otherwise subcontractors will be able to use the online service to appeal against penalties received if no payments were made to subcontractors.

'My Tax' programme

HMRC's vision is to build on the proposed improvements already set out by integrating CIS into its existing digital programme 'My Tax' to enable taxpayers to log on and have instant visibility of transactions. 'My tax' could operate as a 'one stop shop' where Unique Taxpayer References and Company Reference Numbers are integrated in one location and businesses can amend their details online if they change status from a sole trader to a limited company. This will minimise account confusion and reduce errors within the CIS system.

An improved online service would be able to offer a facility for contractors to search for previous verifications. The new service may also include a facility to verify more than one subcontractor at a time. HMRC are also exploring ways to improve the online service to match the service levels given by telephone operators. For example a telephone operator is able to offer assistance in matching subcontractors who have a UTR but a misspelt name or other missing data.

Parent-Subsidiary Directive

The Economic and Financial Affairs Council of the EU has agreed to an amendment to the Parent-Subsidiary Directive. The amendment is intended to prevent cross-border companies from planning their intra-group payments so as to result in double non-taxation where hybrid loan arrangements are involved.

The effect of the amendment is achieved by providing that the member state of the parent company will refrain from taxing profits from the subsidiary only to the extent that such profits are not tax deductible for the subsidiary.

The provisions of the original Directive required member states to exempt from taxation the profits that parent companies received from their subsidiaries in other member states. The intention was to ensure that profits were not taxed twice, and that cross-border groups were thereby not put at a disadvantage compared to domestic groups. However, hybrid loan arrangements enabled cross-border groups to avoid paying taxes altogether by exploiting mismatches between national tax rules. In such cases, the received distributed profits were not taxable in the member state of the parent company, whilst they were treated as a tax-deductible expense in the member state of the subsidiary.

Member states will have until 31 December 2015 to transpose the amendment into national law.

BEPS

The OECD has released its first set of 'deliverables' from its ongoing BEPS action plan. In a press conference which unveiled the first package of seven measures, OECD secretary-general Angel Gurría hailed the recommendations as 'a historical achievement on the long road to global tax justice', adding: 'The G20 has identified base erosion and profit shifting (BEPS) as a serious risk to tax revenues, sovereignty and fair tax systems worldwide. Our recommendations constitute the building blocks for an internationally agreed and coordinated response to corporate tax planning strategies that exploit the gaps and loopholes of the current system to artificially shift profits to locations where they are subject to more favourable tax treatment.'

The seven areas are intended to:

- Ensure the coherence of corporate income taxation at the international level, through new model tax and treaty provisions to neutralise hybrid mismatch arrangements (Action 2). In particular these rules will address structures that use the US 'Check the Box' Regulations where they are used to create hybrid entities.

- Realign taxation and relevant substance to restore the intended benefits of international standards and to prevent the abuse of tax treaties (Action 6). Countries will still be able to fight treaty shopping as they wish but the OECD and G20 Countries have also agreed on a common minimum standard which will require the adoption, at a minimum, of either (1) a combination of the 'limitation-on-benefits' (LOB) rule and of the 'principal purpose test' (PPT) rule; (2) the inclusion of the PPT rule, or (3) the inclusion of the LOB rule supplemented by a mechanism that would deal with conduit financing arrangements.

- Assure that transfer pricing outcomes are in line with value creation, through actions to address transfer pricing issues in the key area of intangibles (Action 8).

- Improve transparency for tax administrations and increase certainty and predictability for taxpayers through improved transfer pricing documentation and a template for country-by-country reporting (Action 13). The country-by-country reporting template will require multinational enterprises (MNEs) to provide annually for each jurisdiction in which they do business, the amount of revenue, profit before income tax, and income tax paid and accrued. Also their total employment, capital, retained earnings and tangible assets in each tax jurisdiction. Finally, the report also requires a listing of all entities doing business within a particular tax jurisdiction, as well as the nature of the main business activities carried out by each entity. The information must be provided to the relevant governments; to protect the confidentiality of potentially sensitive information, it will not be made publically available.

- Address the challenges of the digital economy (Action 1). The report is not recommending the adoption of a 'virtual' permanent establishment. Instead it outlines a new threshold for taxation based on a Significant Digital Presence. Under such a proposal, an enterprise engaged in a 'fully dematerialised digital activities' could be deemed to have a taxable presence in a country if it maintained a 'significant digital presence'.

- Facilitate swift implementation of the BEPS actions through a report on the feasibility of developing a multilateral instrument to amend bilateral tax treaties (Action 15). The goal of a multilateral instrument is to expedite and streamline the implementation of the measures developed to address BEPS, in particular by modifying bilateral tax treaties. It would have the same effect as simultaneous renegoriation of the 3000-odd treaties currently in force.

- Counter harmful tax practices (Action 5). The report notes that a preferential tax regime such as a patent box is useful in supporting growth and innovation in a country if it attracts real activity. It is not so useful if it merely encourages companies to shift profits from the location in which the value was actually created to another location where they may be taxed at a lower rate. One of the key priorities of the BEPS Project has been to focus on whether or not there is substantial activity associated with any preferential regime. The initial focus of this work has been on preferential regimes related to intangible property (IP) and 15 of these regimes are identified in the interim report. Several approaches, with the common goal of ensuring that profits are taxed where substantial activities take place, have been explored. Much of the work has been on the nexus approach, which makes a link between the expenditure incurred in a country (essentially capturing the work or activity undertaken) and the amount of income that can benefit from a preferential regime.

The remaining eight elements of the project are due to be released in 2015.

Next steps

The seven deliverables from the 2014 BEPS package will be presented to G20 finance ministers in September, and to G20 leaders in November. Work has already commenced for the remaining eight elements of the 2015 package, which the OECD Committee on Fiscal Affairs (CFA) will deliver, together with the resolution of pending technical issues and the completion of the implementation measures for the 2014 deliverables. A draft mandate is planned in January 2015 for the CFA's consideration regarding the 'negotiation of a multilateral convention to streamline the implementation of the BEPS action plan', according to the OECD's explanatory statement.

The statement added that: 'Once finalised, these measures are expected to become applicable via changes to bilateral tax treaties or through the multilateral instrument, through changes in domestic laws and with support from internationally agreed guidance.' However, the OECD has given no indication on the actual timing of implementation of the BEPS actions. With more work needed in 2015, it seems likely that 2016 or 2017 would be the earliest period for enactment, although the final action plan to be adopted by all countries involved will need to be translated into domestic legislation.

CIOT tax policy director Patrick Stevens said: 'This first wave of reports is a significant step forward, but the test will be getting international agreement for and implementation of a set of rule changes where there are a range of different perspectives and interests.'

Determinations and deliberate failure by the taxpayer

Summary - The FTT found that determinations issued by HMRC were valid.

Spring Salmon & Seafood carried on business as suppliers, distributors and processors of seafood. Mr Thomas was its director. He also carried on a business in partnership with his brother as consultants and seafood dealers. The main issue was the liability, if any, of the company to pay PAYE and NIC in respect of a £900,000 bonus to Mr Thomas and his brother and wages and salaries of £178,230. The FTT had to decide whether the monies had been paid by the company to the individuals, whether HMRC's determinations were time-barred and whether an alleged 2007 agreement barred HMRC from pursuing the liabilities.

Decision:

The FTT observed that the company's cessation accounts referred to the £900,000 bonus, which was credited to the director's account. It was therefore unreservedly at the disposal of Mr Thomas and his brother (who was a de facto director). Moreover, the company was solvent. Payment was therefore established. As the accounts were prepared by Mr Thomas, who was an experienced businessman, the failure to account for PAYE and NIC must have been deliberate. The PAYE determinations issued by HMRC were therefore not time-barred (TMA 1970 s 36).

Finally, rejecting the appellants' contentions, the FTT found that HMRC had not entered into an argument precluding it from pursuing PAYE and NIC in relation to the sum of £900,000. The agreement not to seek to charge PAYE or NIC was conditional on the company agreeing that the amount was not to be allowed as a deduction from profits. However, the £900,000 bonus had been credited to the director's account in breach of the condition.

Comments - The FTT had clearly very little sympathy for the taxpayer, who it described as 'aggressive and devious'. It also insisted that the failures to account for PAYE and NIC had been deliberate. In such circumstances, the FTT's conclusion that HMRC's determination should stand was to be expected.

Spring Salmon & Seafood v HMRC [2014] UKFTT 887

FII: HMRC cannot rely on the standstill provisions

Summary - The Court of Appeal explained its decision to dismiss HMRC's appeal.

The issue was whether HMRC could amend its defence to rely on the standstill provision in TFEU art 64(1) to deny claims by the claimants for the time value of advance corporation tax (ACT) on third country foreign income dividends (FIDs). The claimants were otherwise entitled by reason of the breach of TFEU art 63, pursuant to the CJEU's decision in the FII Group Litigation (C-446/04). The standstill provision allows some legislation in force as at 31 December 1993, which would otherwise infringe TFEU, to continue.

Decision:

The Court of Appeal found that HMRC was estopped per rem judicatam from raising the issue, as it had already been decided in the High Court [2008] EWHC 2893 and in the Court of Appeal [2010] EWCA Civ 103. In particular, the declarations of the Court of Appeal could only be consistent with the conclusion that the composite FID regime was not saved by the standstill provision.

The court added that the amendment sought by HMRC would be an abuse of process, applying Henderson v Henderson (1843) 3 Hare 100. HMRC's argument was that the obligation under the FID regime — imposed on a UK company to account for ACT on dividends matched with dividends received from third countries — was a separate restriction protected by the standstill provisions. This argument is a point that could have been taken, but was not taken in the High Court and in the Court of Appeal.

Comments - This decision is the latest instalment of an extremely complex judicial saga. Since the decision of the Court of Appeal referred to in this case, there has been a further appeal to the Supreme Court and two further references to the CJEU on separate but connected issues.

HMRC v The Test Claimant in the Franked Investment Income Group Litigation [2014] EWCA Civ 1214

Exclusion of tax advantage on cross-border transactions

Summary - The CJEU found that the exclusion of a tax advantage in a cross-border transaction was not a restriction to the freedom of capital.

Kronos, a US incorporated company managed in Germany, was a holding company which held direct holdings in companies incorporated in other European jurisdictions and in Canada. The dividends paid by foreign subsidiaries, which were exempt from tax under the relevant double tax treaties (the exemption method), were not taken into account in the calculation of the relevant basis for the calculation of Kronos' liability to German corporation tax.

Decision:

The CJEU accepted that in a situation where the company receiving the dividends made a loss, the refunding of the tax paid by the company distributing them could be seen as a tax-flow advantage and that the exclusion of this advantage in a cross-border situation may be a restriction to the free movement of capital. However, the CJEU found that a company receiving foreign-sourced dividends was not in a situation comparable to that of a company receiving nationally sourced dividends. This was because Germany had waived its right to tax foreign-sourced dividends and it could not be required to reimburse a sum originating in the tax system of another country. The lack of refund was also counterbalanced by not taking the dividends into account when determining the basis of assessment.

Comments - The CJEU found that a German company receiving foreign-sourced dividends was not in a comparable situation to that of a German company receiving nationally sourced dividends. This was a rather unusual finding for the CJEU, which stemmed from the fact that Germany had foregone its right to tax (or to take into account) the relevant foreign-sourced dividends.

Kronos International v Finanzamt Leverkusen (C-47/12)

Corporation tax loss relief **(Lecture B858 – 21.40 minutes)**

S44(1) CTA 2010 provides that relief for trading losses against a company's total profits is not available unless, for the loss-making accounting period, the trade was carried on:

- on a commercial basis; and
- with a view to making a profit or (the speaker's emphasis) so as to have a reasonable expectation of making a profit.

For accounting periods ended before 1 April 2010, the equivalent legislation was set out in S393A(3) and (4) ICTA 1988.

In Beacon Estates (Chepstow) Ltd v HMRC (2014), the First-Tier Tribunal allowed the company's appeal against HMRC's refusal to grant it sideways loss relief, holding that the words 'with a view to' in S44(1) CTA 2010 import an objective test when considering this form of trading loss relief.

The principal business of the company was the construction, investing and managing of industrial and commercial property. However, an invitation to travel aboard a yacht in the Mediterranean in the mid-1990s gave the company's managing director the idea that the purchase of a yacht for chartering could be a profitable diversification, especially in light of the buoyant state of the UK and world economies.

A 92-foot motor yacht built in 1993 with 12 guest berths and a crew of five was bought by the company in 1998. For reasons connected with the need to upgrade the yacht to ensure full commercial charter status in compliance with French regulations (the yacht was based in Antibes), the company made losses in relation to its yacht chartering business in each of the years ended 31 March 1998, 1999 and 2000. Having said that, for the next two years, this side of the business became profitable.

Unfortunately, in 2003, the yacht suffered what was described as a 'catastrophic engine failure' which took some five years to fix. During this time, the company did manage to achieve some charter income, but only in respect of static charters, ie. the yacht was moored in one place throughout the charter (either in Antibes or nearby Cannes). Unsurprisingly, this did not prevent further substantial losses accruing.

When business at last resumed in 2008, the company's difficulties in promoting charters were exacerbated by the banking crisis and the subsequent global recession which caused the company to sustain further chartering losses totalling more than £1,000,000 in the years ended 31 March 2009, 2010, 2011 and 2012. On completion of an enquiry into the company's tax returns, HMRC assessed Beacon Estates (Chepstow) Ltd to corporation tax for each of those four years and, in doing so, denied the claims for immediate loss relief in respect of the yacht chartering business. Note that the earlier loss claims in connection with the company's chartering activities had been accepted by HMRC as being in order. The company appealed against the denial of loss relief and this case is the result.

HMRC accepted that Beacon Estates (Chepstow) Ltd carried on the yacht chartering business on a commercial basis between 1 April 2008 and 31 March 2012 (inclusive). Therefore, the issue for the Tribunal to determine was whether this business was undertaken with a view to making a profit (subjective test) or so as to afford a reasonable expectation of making such a profit (objective angle).

The accountant representing the company submitted that the legislation pictured a two-part test, namely that the trade must either be carried on with a view to making a profit or alternatively be carried on so as to afford a reasonable expectation of making a profit. This approach was described as 'tenable' in Glapwell Football Club Ltd v HMRC (2013) – another First-Tier Tribunal decision. He pointed out that, when the tax legislation was rewritten, the use of the word 'or' in S44(1)(b) CTA 2010 clearly envisaged two separate tests. If this had not been intended, Parliament would have used 'and' rather than 'or'. The accountant also argued that the Tribunal should follow the decision of the House of Lords in MacDonald v Dextra Associates Ltd (2005) which, in relation to different legislative provisions, had interpreted 'with a view to' as meaning 'what might realistically happen'.

If this is the case, he contended that, despite the company's earlier losses, Beacon Estates (Chepstow) Ltd did have a realistic possibility of making a profit in its yacht chartering trade. Alternatively, the company had a reasonable expectation of making such a profit and it was pointed out that CTA 2010 does not impose a time limit by which the company was required to make the trade profitable – nor did the predecessor legislation. In other words, in his view, the company passed both the subjective and the objective tests.

HMRC's representative accepted that there was no time limit within which the trade had to return a profit, but he maintained that the company did not carry out its chartering activities so as to afford a reasonable expectation of a profit in the trade. In support of this submission, he argued that, had the yacht chartering trade not been supported by the company's other interests but had operated as a standalone business, it would have failed. Beacon Estates (Chepstow) Ltd, he said, could only have a reasonable expectation of realising a profit if it had relied on the following (unlikely) assumptions:

- the yacht would require no further maintenance or upgrading;
- there would be a large increase in the number of customers willing to charter the vessel (bearing in mind its age); and
- there would be no further unexpected economic shocks.

In the event, the Tribunal disagreed with this latter line of argument. In their words:

'The issue posed by the legislation does not require us to consider previous losses but whether there is a realistic possibility or reasonable expectation of the company making a profit or gain from its chartering activities in the future. After careful consideration, we have come to the conclusion that there is. Charters have been agreed for 2014 and the yacht, which meets the regulations for commercial motor yachts, is marketed and managed through professional chartered agents.

For these reasons, the (company's) appeal is allowed.'

This is a good win for Beacon Estates (Chepstow) Ltd and provides three points of helpful guidance:

The Tribunal followed the principle that 'with a view to' should be interpreted as 'what might realistically happen in the future', as put forward in the Dextra case.

The fact that a company is carrying on a trade on a commercial basis is not sufficient – the 'view to profit' requirement must also be satisfied.

The 'reasonable expectation of profit' test looks ahead at what might realistically happen, but there is no specified time limit within which the profit must be made and the profit in question need not be sufficient to recover previous losses.

In this instance, the Tribunal decided that the objective test was the appropriate one to apply.

The probability is that HMRC will appeal this decision to the Upper Tribunal.

Contributed by Robert Jamieson

VAT

VAT chargeable on cross-border supplies to branches

Summary - The CJEU found that supplies of services between a US holding company and its European branch were taxable transactions.

Skandia had appealed against the decision of the Swedish tax authorities to charge VAT on the supply of services by Skandia America (SAC), established in the US, to its branch Skandia Sverige (Sverige), established in Sweden.

SAC sold externally purchased IT services to Sverige, which processed them and sold a final product to companies within the group.

Decision:

The CJEU first observed that a supply of services is only taxable if a reciprocal legal relationship exists between the supplier and the recipient. Here, this depended on whether Sverige carried on an independent economic activity. The CJEU found that Sverige did not function independently and was not therefore a taxable person. However, because Sverige belonged to a VAT group, services it received were deemed to be supplied to the group.

On the basis that SAC and Sverige could not be considered as a single taxable person, supplies by SAC to Sverige must be taxable transactions.

Finally, as the services were supplied by SAC, a company established in a third country to Sverige, a company established in a member state, Sverige was liable for the VAT (Sixth Directive art 56).

Comments - This decision will have negative implications for financial businesses, such as banks and insurance companies, which make exempt supplies and are therefore unable to recover a large proportion of their input tax. Until now, such businesses have not suffered VAT on cross-border supplies within the same legal entity. The key outstanding issue is how HMRC will implement the decision.

Skandia America v Skatteverket (C-7/13)

Windfall repayments are legal

Summary - The ECJ found that the company is entitled to claim VAT repayments on repossessed hire-purchase cars that were later resold VAT free.

The taxpayer, GMAC, was registered for VAT and supplied cars on hire purchase terms. HMRC had accepted that if there was a consensual termination of a hire purchase contract relating to a motor car, following which the vehicle was sold, as a result of reg 38 of the VAT Regulations 1995, GMAC was to be treated as having made the supply of hire purchase in return for a consideration reduced by the amount of the sale proceeds.

However, until the High Court decided that the same rule applied in CRC v General Motors Acceptance Corporation (UK) plc [2004] STC 577, the Revenue had not accepted that the same rule applied when the hire purchase customer defaulted and the car was repossessed and sold at auction by the taxpayer. As a result of that decision, the taxpayer made a claim for bad debt relief for the period from 1978 to 1997, on the basis that hire purchase contracts had been ended because the agreed sale price had not been paid.

HMRC rejected the claim, saying this would result in a windfall repayment that was not intended by EU VAT law. The effect would be that on the sale of a repossessed car at an auction, GMAC would pay less VAT than a taxpayer who sold a car in an outright sale.

HMRC therefore ruled that bad debt relief should not apply. The First-tier Tribunal allowed the taxpayer's appeal, but the Upper Tribunal referred it to the Court of Justice of the EU for a preliminary ruling.

Decision:

The court said that a member state could not prevent a taxable person from invoking the VAT directive in respect of one transaction by arguing that the business could rely on the provisions of national law in relation to another transaction concerning the same goods.

In essence, the ECJ stated that the company is entitled to claim VAT repayments on repossessed hire-purchase cars that were later resold VAT free.

Comments - Darren Mellor-Clark of Pinsent Masons said: "The ECJ has ruled that a member state should not refuse issuing a VAT refund by hiding behind its own failure to anticipate an interaction between the VAT rules on a domestic and international level. To some extent, the court is modifying a well known maxim in telling HMRC and the UK government 'caveat scriptor' or let the writer beware. The power to draft legislation is accompanied by the responsibility to ensure that it produces the desired consequences."

The decision will, of course, be excellent news for car hire purchase companies. More specifically, GMAC should now obtain bad debt relief for the period from 1990 to 1997, but the earlier period (1978 to 1989) may be time-barred.

GMAC UK plc v CRC (Case C-589/12), ECJ

Which party should bear the VAT?

Summary - The Court of Appeal found that the vendor of an opted property should bear the cost of the VAT due on the sale.

CLP had sold an opted property to the defendants and the key issue was whether the contract imposed upon the defendants an obligation to pay the chargeable tax to the claimant.

Decision:

Kitchin LJ observed that this should be ascertained by working out what a reasonable person would have understood the parties to have meant — regardless of the parties' subjective intention. He also noted that in a contract which contained both special and general conditions, the court should preserve the general conditions so far as possible. General provision 1.4 provided that an obligation to pay money included any obligation to pay VAT and that all sums payable under the contract were exclusive of VAT. Kitchin LJ accepted that general condition 1.4 clearly meant that the defendants were liable to pay the VAT to the claimant. However, Kitchin LJ added that the claimant had not told the defendants that it had exercised the option to tax and that there was no reason for them to suspect that the property was subject to tax. Furthermore, no communication between the parties suggested that VAT was payable. Finally, the special conditions specified that the purchase price was £130,000 and did not provide that the price was exclusive of VAT. In case of conflict, the special conditions must prevail over the general conditions.

Kitchin LJ therefore concluded that a reasonable person would conclude that the parties had intended that nothing would be payable over the price of £130,000. Gloster LJ and Arden LJ agreed.

Comments - This case is a useful example of the way the court will approach a contract which does not clearly specify which party shall bear the cost of VAT (if any). The approach of the Court of Appeal was fact specific; the fact that the defendants did not know that the property was opted seems to have carried a lot of weight. More generally, this decision is a reminder that any contract for sale should stipulate whether the vendor is to be indemnified by the purchaser in the event that VAT is payable.

CLP Holding v Singh and Kaur [2014] EWCA Civ 1103

Card handling services and the VAT exemption

Summary - The FTT held that there had been no abuse, but referred the VAT treatment of card handling services to the CJEU.

Bookit, a subsidiary of Odeon Cinemas, charged card handling fees to customers making advance bookings for cinema tickets. Until 2001, Odeon had provided these services itself. After consulting Deloitte & Touche, it had then restructured its ticket sales in order to ensure that the card handling fees were exempt from VAT. The issue was whether the card handling services were 'transactions concerning payment' (Sixth VAT Directive art 135(1)(d)) and therefore prima facie exempt; and, if so, whether they were excluded from the exemption by virtue of constituting debt collection services.

Decision:

The FTT felt unable to distinguish the provision of financial information without which a payment could not be made but which does not fall within the exemption (as in Nordea (C-350/10)) from those data handling services which functionally have the effect of transferring funds and which, according to the CJEU in SDC (C-2/95), could fall within the exemption. The FTT therefore decided to refer the issue to the CJEU.

The FTT noted, however, that 'debt collection' implies collection on behalf of the creditor and is therefore a service provided to the creditor. The debt collection carve out could not therefore apply to services supplied by Bookit.

As to the question of abuse, the FTT referred to the well established principle that taxpayers may choose to structure their business so as to limit their tax liability. The burden was therefore on HMRC to show that the arrangements were abusive. The FTT found that the contractual arrangements accorded with economic and commercial reality. Bookit had the staff, facilities and necessary contracts to provide the card handling services. There was therefore no artificiality. Similarly, Odeon had been entitled to keep Bookit out of its VAT group to achieve the desired tax result.

Comments - The case is a useful reminder that the Halifax doctrine cannot be applied to any arrangement put in place for VAT avoidance purposes. Here, as in Lower Mill Estate [2010] UKUT 463, two connected companies provided separate supplies and it was not open to HMRC to redefine them as a single supply.

Bookit v HMRC [2014] UKFTT 856

Yacht used for both business and personal purposes

Summary - The FTT reviewed the way HMRC had apportioned input tax incurred on the acquisition of a yacht used for both business and private purposes.

The appellant had purchased a yacht for the dual purpose of running a chartering business and personal use. The issue was whether the so-called Lennartz method of accounting for output tax was appropriate. In Lennartz [1995] STC 514, the CJEU had held that a taxable person is entitled to recover input tax incurred on the purchase of goods, however small the proportion of business use of such goods. The yacht had quickly become a 'white elephant'. The chartering market had been badly affected by the recession and, for various reasons, the appellant and his wife had not been able to use it for leisure purposes.

The appellant contended that the Lennartz method should not apply. He had not intended to apply the method when acquiring the yacht and had intended to pay a commercial rate for the private use of the yacht. The yacht was therefore solely used for business purposes. The taxpayer also took issue with HMRC's allocation to private use of a large proportion of the time when the yacht was idle.

Decision:

The FTT observed that the taxpayer had intended to reclaim all the input tax incurred on the purchase of the yacht and had therefore allocated the vessel entirely to its business — and had charged VAT on hire accordingly. Later on, he had attempted to claw back some of the tax. The FTT also accepted HMRC's evidence that the yacht had been used for personal purposes 1/12th of the time.

The FTT however disagreed with HMRC's treatment of the idle periods as private use periods, pointing out that the legislation refers to 'private use', not to the 'possibility of private use', because the yacht is not required for business purposes. The FTT noted the resulting distortion; a calculation supposedly based on 1/12 private use had led to an output liability of over 60% of the original input tax recovered.

The FTT also found that some of the assessments had been time-barred. It accepted, however, that time had started running from the point HMRC received the relevant information; this was when the percentage of private use had been communicated to their direct tax colleagues.

Comments - The confirmation that an asset used for both business and private purposes should not be deemed to be used for personal purposes when idle could be relevant to many types of businesses.

TJ Charters v HMRC [2014] UKFTT 896

VAT and games of chance

Summary - The UT found that 'spot the ball' was not a game of chance.

The UT had to decide whether the game of 'spot the ball' was a game of chance, and therefore exempt from VAT (Sixth Directive art 13(B)(f)). In all versions of the game, a photograph of a football match was taken. The football was then removed from the photograph (along with much of the rest of the background) and participants had to guess the exact location of the centre of the missing football.

Decision:

The UT observed that a game is an activity under rules which provide for an outcome 'such that it can be said that a player has won or lost'. In a typical 'game of chance', the rules provide for some event occurring randomly after the start of the game to influence its outcome to a significant degree. The effect produced by the uncertain outcome of the random element is one of the purposes of the game.

The UT found that the activities involved in 'spot the ball' — looking at a picture and posting a coupon marked with an 'X' showing the location of the ball — did not constitute the playing of a game. Furthermore, there were no rules setting out how the game should be played.

Disagreeing with the FTT, the UT therefore concluded that 'spot the ball' was a competition involving an element of chance, but that it was not a game.

Comments - The taxation of betting and other games has led to much litigation and this decision referred to a plethora of case law to identify the meaning of the phrase 'playing a game of chance'. The case is therefore a useful reference for anyone wishing to argue that they fall within the exemption.

HMRC v IFX and others [2014] UKUT 0398

Proper penalty decided

Summary – The Tribunal held that a penalty of only £400 was appropriate when a taxpayer failed to register

The taxpayer was a self-employed roofer who was late registering for VAT by five years. HMRC imposed a penalty of £7,204, which they later mitigated to £3,602.

The taxpayer appealed. He said as soon as HMRC told him that he should have registered for VAT, he did so. Once he was told the threshold for 2008/09 (£67,000), he believed his turnover exceeded this amount only in 2008 and 2010. When he registered in 2013, his expected turnover was about £51,000.

Decision:

The First-tier Tribunal decided that the taxpayer had taken the matter seriously once he found out he should have been VAT registered and that he supplied information swiftly to HMRC. Bearing that in mind, the penalty was "excessively harsh for someone who has in effect made their first mistake".

The tribunal judge said the legislation in VATA 1994, s 70(1) did not restrict the tribunal to reducing the penalty by particular percentages, but allowed it to reduce it to an amount it thought "proper".

The judge considered that a penalty of £400 was appropriate and allowed the appeal in part.

Comments - Neil Warren, independent VAT consultant, said: "There was no explanation as to how the tribunal arrived at a penalty figure of £400. It commented that the taxpayer had only gone over the threshold because of one big contract, and also due to a limited time period when he employed three other roofers. He had a total lack of awareness about VAT registration thresholds and had never employed an accountant until after the VAT problem arose. The tribunal recognised that he would probably have organised his affairs differently to avoid a VAT problem if he had more knowledge. In reality, this was a good outcome for the taxpayer: another tribunal chairman could have reached a very different conclusion and upheld the penalty in full."

J Lee v HMRC TC3758

E-books and the reduced rate of VAT

Summary - The CJEU found that national courts should decide whether e-books and audio books should be treated like paper books for VAT purposes.

K is a publishing company with activities which include the publication of general literature and textbooks. It also publishes audio books and e-books available on a range of physical supports; in particular, CDs, CD-ROMs and USB keys. The issue was whether books published on physical supports other than paper could be regarded as books for the purpose of VAT under EU law and Finnish law and therefore subject to a reduced rate.

K contended that the exclusion of books published in non-paper form from the reduced rate of VAT was contrary to the principle of fiscal neutrality, which precludes similar goods that are in competition with each other from being treated differently.

Decision:

The CJEU observed that whether goods are similar must be assessed from the point of view of the 'typical consumer'. Goods are therefore similar if they have similar characteristics and meet the same needs, their use being comparable, so that the differences between them do not have a 'significant influence' on the decision of the average consumer to use one or the other. Consequently, if what matters to the consumer is essentially the content, regardless of the support, the selective application of a reduced rate of VAT is not justified. The view of the 'typical consumer' must be ascertained by the national court.

Comments - The CJEU observed that the view of the 'typical consumer' may depend on the degree of penetration of new technologies in each national market. The VAT treatment of e-books is therefore likely to vary between physical supports, member states and over time, as new technologies become more widely available. Uncertainty is not over for publishers.

K Oy v Keskusverolautakunta (C-219/13)

HMRC Guidance following the BAA case in EWCA

HM Revenue and Customs (HMRC) has reviewed its policy following the decision of the Court of Appeal in the case of Briitish Airport Authority (BAA) ([2013] England and Wales Court of Appeal Civ 112). The decision confirms that VAT is only recoverable where there is a direct and immediate link to taxable supplies. BAA was refused permission to appeal to the Supreme Court. For the purpose of this brief, “taxable supplies” includes supplies not charged to UK VAT, but which carry a right to input tax recovery.

Following this decision there is no change in HMRC’s policy. However the facts in BAA related to particular circumstances and the decision does not address other commonly encountered issues relating to holding companies. HMRC has therefore updated its guidance to set out when HMRC considers that VAT recovery may be possible.

The revised guidance can be found at VAT Input Tax Manual

Taxpayers should be aware that the German cases of Larentia + Minerva and others (C108/14 and c-109/14) have been referred to the Court of Justice of the European Union (CJEU). The decision in those cases is likely to be relevant to the issues described in this brief and the guidance referred to in this brief. HMRC will review the policy contained in the guidance in the light of the CJEU’s determination of this reference, which is expected in approximately 12 to 18 months.

Background

A UK company, Airport Development and Investments Ltd (ADIL), which was owned by an investment consortium, made a bid to acquire the entire issued share capital of BAA plc. During this process ADIL received supplies of services in connection with the takeover bid. The takeover bid was successful and, subsequently, ADIL joined the BAA VAT group which then sought to recover the VAT that ADIL had incurred on those services.

The Court of Appeal noted that there are 2 conditions for the recovery of VAT. Firstly the tax must be incurred by a taxable person in the course of an economic activity. Secondly the goods and services on which the VAT is incurred must have a direct and immediate link with taxable supplies made by that person.

The Court of Appeal held that the BAA VAT group was not entitled to recover the VAT incurred on the costs of acquisition because when ADIL incurred the VAT:

- it was not carrying on an economic activity for VAT purposes, but was merely intending to takeover BAA plc by acquiring the shares in it, and
- there was no direct and immediate link between the services received by ADIL and the taxable supplies made by the BAA VAT group

The Court of Appeal found that ADIL did not make, nor intend to make, taxable supplies of goods or services at the time the VAT was incurred. Acquiring the shares had economic consequences, but that did not mean ADIL was engaged in an economic activity for VAT purposes.

New guidance covers the following issues

- when a shareholding is used as part of an economic activity
- when VAT may be recoverable by a holding company
- the effect of a holding company joining a VAT Group
- how to treat mixed economic and non-economic activities

More than one excise duty point?

Summary - The FTT held that there can only be one excise duty point.

B&M Retail is a leading retailer of alcoholic beverages. It procures stocks of alcohol for retail sale from suppliers; under B&M's terms of business, the suppliers are required to warrant the sale of the alcohol as 'excise duty paid'.

During a visit of B&M's warehouse, HMRC detained goods (later, seizing them) under CEMA 1979 s 139, on the ground that excise duty had not been paid on these goods.

The issue was whether there could be more than one release for consumption (under the Excise Goods (Holding, Movement and Duty Point) Regulations SI 2010/593, reg 6).

HMRC contended that the provisions reflected a continuous state of affairs, whereas B&M argued that the provisions referred to a 'snapshot' and therefore a single release for consumption.

Decision:

The FTT observed that the term 'release' suggested a single event and added that the language of the 2010 regulations did not lend itself to a pattern of sequential detention and release.

The FTT concluded that once goods had been released they could not be charged with duty again; and therefore a person could not be liable for duty if, before he held the goods, an identified excise duty point had arisen.

Comments - In confirming that there can only be one excise duty point, the FTT's decision is a very useful reference for retailers of alcohol and cigarettes.

B&M Retail v HMRC [2014] UKFTT 902

Partial exemption - input tax allocations (Lecture B859 – 14.25 minutes)

Partial exemption is one of the most important aspects of the tax. And one of the key decisions made by a partly exempt business is to decide how to apportion VAT on expenditure between the three different categories of input tax.

Three categories of input tax for a partly exempt business

1. Taxable input tax – expenditure wholly relates to taxable sales (including zero-rated sales) – 100% input tax claim subject to normal rules
2. Residual input tax – expenditure has a link with both taxable and exempt income (eg general overheads of a business) so is partly claimed – usually based on the standard method based on income splits
3. Exempt input tax – expenditure wholly relates to exempt sales – no input tax is claimed.

Note – if exempt input tax is quite low (including the proportion of residual input tax not claimed), then a business might still claim all of its input tax under the partial exemption de minimis rules – HMRC Notice 706, section 11.

Direct and immediate link

The key phrase as far as input tax recovery is concerned is 'direct and immediate link'. This phrase made its debut back in 1995 in the landmark ECJ case of BLP (C-4/94) and has stood the test of time. What does it mean exactly?

To give an example, if I am a non-profit making theatre company, making exempt supplies of ticket sales to put on shows, then I will almost certainly pay a range of production companies – and these fees will be subject to VAT. So would it be possible for me to argue on behalf of the theatre company that the input tax on the production company fees should be treated as 'residual input tax' on the basis that if the show is good, then not only will sales of exempt ticket sales be high but also the bar sales (taxable income) will increase before and after the show (and during the interval of course as well). This argument is logical but unfortunately the link between the costs of the production company and the bar sales is an 'indirect' link – not good enough to justify the expenditure being treated as residual input tax.

A small link is enough…….

Imagine the following situation: I am an estate agent and my two sources of income are from mortgage commission (exempt) and commission from selling houses (taxable). I am about to put an advert in the Oxford Gazette to advertise my mortgage services, which will cost me £5,000 + VAT. What is the input tax position?

As far as partial exemption is concerned, the £1,000 input tax will be a cost to my business ie wholly irrecoverable as exempt input tax. But what if I amend the advert slightly and include in the bottom left hand corner of the advert a small logo and the phrase: "We will also sell your house for you if you are thinking of moving." This amendment, which might only take up 5% of the space on the advert, is enough to move the input tax from 'exempt' to 'residual' because there is now a 'direct and immediate' link between the advert and both my taxable and exempt activities.

Two recent tribunal cases…….bingo clubs and museums

In the case of Roald Dahl Museum and Story Centre (TC3445), the museum paid VAT on certain expenditure incurred in refurbishing and maintaining exhibits concerning the life and work of the author Roald Dahl. The Museum argued that such expenditure was 'residual input tax' because as well as there being a direct link to exempt admissions to the museum, the expenditure also increased taxable sales from the museum shop of eg books and other merchandise. Although this argument was rejected by the tribunal, who agreed with HMRC that the input tax was wholly linked to exempt admission sales, it did agree that input tax on the cost of designing one particular gallery could be claimed (£51k of input tax) because the Museum published a book for sale called 'The Hut Book', which contained photos and explanations of the items in the gallery ie a direct and immediate link to taxable sales. The 'Hut Book' was apparently a key part of the gallery refurbishment for both commercial and curatorial reasons.

The outcome of this case highlights the point I made earlier that even if a small link can be established between expenditure and taxable sales, then the input tax will be at least partly recoverable.

In the case of Buckingham Bingo Ltd (TC3093), the court had to consider the input tax treatment of promotional items given to members. The items given away by the club were linked to the number of times that a member had paid an admission fee to enter the main foyer of the club (the admission fee was taxable income and the member's card was stamped on each occasion they paid the fee). The main foyer comprised a meeting area that provided refreshments and other faciltiies, and many members only enjoyed these facilities on a visit, without going into the main hall to play bingo. HMRC maintained, however, that the input tax on the promotional items should be treated as residual input tax and only partly recoverable because many members then paid a separate fee to go into the main bingo hall and play bingo (and participation fees are exempt from VAT ie the promotions were encouraging use of all club facilities).

The tribunal fully considered the 'direct and immediate link' issue and concluded that the only relevant link related to admission fees to the main foyer ie fully reclaimable as taxable input tax.

Note – the key legislation is: Value Added Tax Regulations 1995, SI1995/2518, reg 101.

What about the golf clubs?

HMRC confirmed in R&C Brief 25/14 that green fee income for non-profit making golf clubs should be exempt from VAT according to EU law ie on the basis that the exemption should apply to all sporting facilities provided by such clubs and not just to those facilities supplied to members. This policy change was made as a result of the CJEU case of Bridport and West Dorset Golf Club Ltd (Case C-495/12). But what does it mean for the clubs as far as partial exemption is concerned?

As an opening comment, the fact that more of a club's income will be VAT exempt rather than standard rated means that there will be a reduction in the percentage of residual input tax claimed each quarter if the club uses the standard method based on income. So it might be worthwhile considering a special method of calculation instead – perhaps to apportion eg clubhouse expenditure on the basis of square footage between the different activities (taxable bar and exempt golf changing rooms etc). But don't forget that HMRC need to approve the use of a special method and the club will need to certify that the proposed method gives a fair and reasonable result as far as input tax recovery is concerned.

However, the major issue is that if green fee income is VAT exempt, along with member fees and joining fees which have always been exempt, does the club now have any taxable income at all from the golf course? If not, then the input tax on all course expenditure (eg equipment to cut the grass, fertiliser/grass seed) will become 'exempt' rather than 'residual' as far as partial exemption is concerned.

Input tax issues for non-profit making golf clubs now that green fee income is exempt from VAT

If the club earns advertising income from local firms having a board or flag at various golf holes on the course, is this income enough to create a 'direct and immediate' link between taxable income and course expenditure?

A similar issue was considered in the case of Cirencester Rugby Club a number of years ago (case ref: TC00718), in relation to the input tax treatment of the costs of a new rugby pitch – and it was ruled that the boards around the pitch were enough to justify a partial reclaim of input tax ie as residual. Note – in some cases, space provided for advertising hoardings could be exempt from VAT as a land supply but unlikely in this situation.

What is the VAT liability of corporate green fee bookings? We know that individual green fees are now VAT exempt following the Bridport and West Dorset case – but what if, for example, a local bank buys 10 rounds of golf for staff/customers for a golfing day? Is this income still taxable? My personal view (unfortunately) is that it is VAT exempt because it still relates to individuals taking part in sport, albeit that the booking has been made by a corporate organisation. The case of Canterbury Hockey Club (C-253/07) supports this view.

If a club earns commission from a self-employed golf professional for encouraging members or guests to have golf lessons with him, then this income will be taxable for the club and it will also be linked to the golf course if the professional uses the course to teach his students. This link looks encouraging because it there was no golf course, properly maintained, there would be no lessons ie giving a direct and immediate link between the course and taxable income. I appreciate that golf lessons will be only a small percentage of the activity taking place on the course but as my earlier example of the estate agent illustrates, this is enough to create a link as far as partial exemption is concerned.

Contributed by Neil Warren

Mixed supplies – a logical approach (Lecture B860 – 12.38 minutes)

Why is this an important topic in the VAT world?

This is important because:

- A business making sales to the general public (or any customer that cannot claim input tax) does not want to overpay output tax – which would happen if part of a sale was treated as standard rated instead of zero-rated or exempt
- HMRC could assess output tax if they think a partly zero-rated/exempt sale should be wholly standard rated – and they have the power to assess tax retrospectively for the last four years.

What is a 'mixed supply'?

A mixed supply basically means that a business is selling more than one item, or more than one service or a combination of goods and services, where more than one rate of VAT is involved in the transaction. So there would be no problem if a business sold a single package that consisted of a hardback novel and a pint of milk because both items are zero-rated within the legislation. But there would definitely be a VAT challenge if the milk was substituted for a bar of chocolate.

The challenge is now as follows:

- Is the main supply the zero-rated novel with the value of the standard rated chocolate bar being an 'incidental' item that can be ignored - in which case the entire payment from the customer will be zero-rated
- If the customer clearly expects to receive two items in return for his payment, both subject to different rates of VAT, then the output tax must be apportioned.
- Unlikely, but if the main supply is the chocolate bar and the novel is 'incidental' then the whole payment will be standard rated.

To give another example, the purchase of a music DVD is wholly standard rated, even though the package might include a very well-written zero-rated booklet giving details about the performer's history and future plans. The booklet is incidental to the main supply of the music and, to use another phrase considered by the courts on the mixed supply issue, a tool to enhance enjoyment of the main supply. In contrast, if someone travels on the Orient Express and pays for a package consisting of the train journey and a four-course meal with champagne, this is clearly a mixed supply of zero-rated rail travel and standard rated catering, with output tax apportionment being necessary.

CPP case.......did it clear the cloudy waters?

HMRC and the VAT profession thought (perhaps somewhat optimistically) that the issue of VAT on mixed supplies was fully resolved when the European Court of Justice (ECJ) gave its landmark ruling in 1999 in the case of Card Protection Plan Ltd (case ref C-349/96). It gave a series of guidelines to follow in each transaction, the end result hopefully being a consistent approach on this topic throughout the EU. But we still get a lot of tribunal cases on this subject where both HMRC and taxpayers get things wrong.....and in some cases even the courts disagree with each other!

Key tip – look at the sale from the customer's viewpoint

My key tip on this topic is to always look at a transaction from the viewpoint of the customer rather than the supplier. For example, if I bought a DVD and there was no leaflet in the package, would I complain to the record company to demand a refund? The answer is 'no' but I would almost certainly complain if there was no food and drink provided on the Orient Express trip I mentioned......that is definitely a mixed supply. In other words, does the customer think he is paying for more than one benefit (goods or services) when he parts with his cash – or is the reality that he is paying for one main benefit, with any other items being 'ancillary' to this one main benefit ie a single supply outcome.

Recent VAT case……..taxpayer victory

In the case of Envoygate (Installations) Ltd (TC3361), a specialist window company had two main sources of income:

- Manufacture and installation of sash windows to residential properties – subject to 20% VAT
- Manufacture and installation of draught stripping for windows in residential properties – subject to 5% VAT as an energy saving material (VATA1994, Sch 7A, Group 2, Items 1 and 2).

Despite the fact that the customer had the choice of ordering the windows or draught stripping on a stand-alone basis, HMRC took the view that an order for both represented a single supply of sashed windows ie all subject to 20% VAT. This conclusion was reached despite the fact that there was separate pricing arrangements (the draught stripping supply tended to be about 50% of the cost of the replacement windows), separate brochures to promote the different services of windows/draught stripping and also separate invoicing. HMRC felt it would be artificial to separate the supplies.

The taxpayer's appeal was successful – the tribunal accepted that there were two separate supplies at different rates of VAT and an output tax split was appropriate.

To quote from the report:

"Physically the customer receives, and has fitted separately, two distinct items, the replacement window and the draught stripping. Neither is, as to its nature, features or its function, dependent upon the other. The draught stripping is not attached to the replacement window, but to the customer's fixed window frame. The replacement window functions as a window (letting in light, keeping out weather whilst closed, letting in air whilst open) without the draught stripping."

Shop in shop arrangement – another case

Finally, Box 1 shares another interesting mixed supply case considered by the First-tier Tribunal last year – the key feature of this case is that the court rejected both the taxpayer's argument that a supply to a tenant was wholly VAT exempt as 'rent' and HMRC's view that the whole supply was standard rated as a 'selling agency' service and felt instead that it was a bit of each ie a mixed supply outcome.

Box 1 - Antiques Within Ltd (FTT case TC2507) – a mixed supply outcome

The taxpayer charged six antique dealers between £50 and £100 a week to rent space in its shop ie as a shop-in-shop arrangement. However, the company also tried to sell stock on behalf of the tenants if they were not present in the shop. HMRC viewed the arrangement as a standard rated supply of a selling agent service – the taxpayer treated the income as VAT exempt for rent ie use of land in the shop by the tenant.

Outcome – the court disagreed with both parties and concluded a mixed supply outcome ie the customer (tenant) expected both the land in the shop and the energies of the landlord in trying to sell some of his stock. The conclusion of the court again highlights the key principle I mentioned earlier, namely the need to consider this subject from the viewpoint of the customer rather than the supplier.

Contributed by Neil Warren