# Tolley®CPD

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# Personal Tax

## Self-employed status confirmed by Tribunal (Lecture P863 – 16.05 minutes)

*Summary – The Tribunal confirmed that the taxpayer was self-employed*

The taxpayer, EMS, was a company that organised the recovery of damaged motor vehicles on behalf of insurance companies. One of its contractors was DKM Services, owned by M. EMS paid M an hourly rate on presentation of invoices. For many years, DKM Services relied solely on EMS for work.

HMRC said that M was an employee of EMS and that the company should deduct PAYE tax and National Insurance on M's earnings. The taxpayer said M was an independent contractor and should be treated as self-employed.

*Decision:*

The First-tier Tribunal said it was for the taxpayer to show M was self-employed and there was no "magic formula". The tribunal referred to the tests set out in the decision in Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance [1968] All ER 433. It found that EMS exerted no control over how M carried out his job after having agreed what needed to be done.

As to financial risk, there was no guarantee of work from EMS and M paid for his own equipment, safety clothing and training. He also bore the risk of the customer defaulting. He had to arrange his own pension and insurance, and was paid only when he worked, ie he had no holiday entitlement from EMS.

In addition, the tribunal said EMS did not have exclusive rights to M's services, even though most of M's work was derived from EMS.

The tribunal concluded that M was self-employed: both M and EMS believed that the latter took on M as an independent contractor.

The taxpayer's appeal was allowed.

**Comments –** In many self-employment v employment cases it is necessary for the Tribunal chairman to go through the list of factors specified by the President of the Tribunal in 2002 when determining the status of an individual. It was clear that the weight of the factors weighed in favour of self-employment. There are many cases which provide useful guidance on the various factors and the Ready Mixed Concrete case is one the key cases.

*EMS (Independent Accident Management Services) (TC4006)*

## Official Rate of Interest

HMRC has announced that the official rate will remain at 3.25% for the quarter from 6 October 2014.

## New pension planning from 6 April 2015 (Lecture P861 – 13.31 minutes)

The flexibility which will apply to Defined Contribution Pension Schemes (such as Personal Pension Schemes or Money Purchase Schemes) from 6 April 2015 has now been detailed in the ***Taxation of Pensions Bill*** following a draft version which was subject to consultation.

Originally it was expected that with flexibility we would also see a large degree of simplification. That sadly is not the case, as evidenced by HMRC draft guidance notes which extend to 55 pages. There are also some complex rules where pension benefits have already been taken before 6 April 2015.

Another disappointment is that the Bill on the face of it encouragingly includes a permissive scheme rule override in connection with many payment options, so that the fact that the scheme rules may not allow payment to be made under the new flexible option regime is ignored. However, the scheme trustees will NOT be compelled to allow the member to use the new regime. If they refuse the only available option is to transfer the fund to a more enlightened pension provider. That, however, can involve substantial transfer charges which are not capped. Hopefully the element of competition between pension providers will reduce or even eliminate these issues in the future.

The new rules will still be subject to the lifetime allowance of £1.25million.

The driving force behind the dramatic changes is the ever-reducing annuity rates which have basically halved over the past 15 years. In addition an annuity is inflexible, although may still be the correct choice if certainty is required from funds held for retirement.

The main options

1. If aged at least 55 (or, if later, 10 years' before the normal date of entitlement to the state pension) take the funds as an income for life, by purchasing an annuity or taking a scheme pension OR

2. Flexible access by way of:

- putting the funds into a drawdown fund known as a ***flexi-access drawdown fund*** from which you can draw any amount over any period (subject to possible restrictions or cost issues imposed by the pension provider) as if the pension fund was a bank account: or
- taking a single lump sum, or a series, from uncrystallised funds known as ***uncrystallised funds pension lump sum***; or
- using a combination of the above

The tax position on flexible access options

This is of fundamental importance in deciding the best course of action. It is summarised below:

- payments from a ***flexi-access drawdown fund*** are taxed as a pension, but when funds are placed into such a fund you can take up to 25% of the fund tax-free as a ***pension commencement lump sum***

- any payment of an ***uncrystallised funds pension lump sum*** is 25% tax free with the balance taxed as if it were a pension
- this means that you can still obtain a tax free 25% of the whole fund in one go if desired, at the time the funds are placed into a ***flexi-access drawdown fund***, or if preferred you can take 25% tax free on each drawdown

Lifetime annuity

The annuity market will still have a role to play. A lifetime annuity must be payable at least annually to the member and continue at least up to his death. It cannot be surrendered before death.

The current restrictions are being removed as follows from 6 April 2015:

1. The annual annuity rate can go down as well as up.

2. The member will no longer be subject to the unauthorised payment charges if they have not had an opportunity to select the insurance company paying the annuity.

3. The current 10-year restriction on the maximum guarantee period for paying the income from a lifetime annuity will be removed. A lifetime annuity may continue to be paid after the member's death for any period that is set out in the annuity contract.

In addition, if a drawdown pension is chosen this can be in the form of income withdrawal as and when required OR passing some or all of the drawdown funds to an insurance company to buy a short-term annuity for up to 5 years.

Money purchase annual allowance rules

The rules ensure that individuals do not use the new flexibilities, which are intended to provide people with greater access to their retirement savings, to avoid tax on their current earnings by diverting them into their pension fund with tax relief due, and then immediately withdrawing 25% tax-free.

The main details are:

1. If you trigger the money purchase annual allowance rules you will have a £10,000 annual allowance for money purchase pension savings subject of course to having earnings to cover. This reduction does not apply if an annuity has been purchased.

2. If you exceed this £10,000 limit, you will also have a reduced £30,000 annual allowance (instead of the normal £40,000) for your Defined Benefits Pension savings, if there are any.

3. If you do trigger the money purchase annual allowance rules and exceed the £10,000 allowance in any tax year you will be subject to the annual allowance charge on the excess.

4. If you do not exceed the £10,000 money purchase annual allowance your total annual allowance, including for money purchase and defined benefit arrangements, will continue to be £40,000 plus any unused annual allowance carried forward from the three previous tax years.

5. An election is available to require the pension scheme to pay the annual allowance charge if that is greater than £2,000 ( = the *scheme pays facility*), but it can only be arranged on a voluntary basis if the £10,000 limit applies and is exceeded, rather than the £40,000 limit.

6. There is no scope to carry forward any unused money purchase annual allowance.

7. Within the £10,000 limit there is some scope to provide a useful return as under and subject to (a) the pension provider's willingness to cater for it and (b) their charges being acceptable.

| Tax rate: | 20% | 40% | 45% |
|---|---|---|---|
| | £ | £ | £ |
| Gross contribution | 10,000 | 10,000 | 10,000 |
| Tax relief | (2,000) | (4,000) | (4,500) |
| Net contribution | 8,000 | 6,000 | 5,500 |
| Tax-free lump sum | (2,500) | (2,500) | (2,500) |
| Taxable lump sum | (7,500) | (7,500) | (7,500) |
| Income tax | 1,500 | 3,000 | 3,375 |
| Annual net profit | 500 | 1,000 | 1,125 |

Recycling rules

These change from 6 April 2015 and apply to taking a lump sum from a pension scheme and using it to fund a pension scheme contribution.

It will apply where the lump sum plus any received in the previous 12 months exceeds £7,500, instead of the previous limit of £12,500 (1% of the lifetime allowance), and at least 30% of the lump sum is used to make a significantly increased contribution on a pre-planned basis.

The contribution is regarded as significantly increased if it is 30% more than the contribution which would have been expected in a 5 year period which starts 2 years before the tax year of receipt of the lump sum.

***Illustration***

*In 2015/16 Ms A receives a lump sum from her pension scheme of £30,000. She had paid £8,000 per annum into the scheme in the last 6 tax years.*

*As a result of receiving the lump sum she paid £20,000 into a pension scheme.*

*Result:*

- *Increased contribution of £12,000 (£20,000 less £8,000) exceeds 30% of usual contribution of £8,000*
- *Lump sum of £30,000 exceeds £7,500 and more than 30% of it is used to fund the contribution*
- *Ms A is taxed on the unauthorised payment of £30,000*

Making an increased contribution following receipt of a lump sum is **not** caught in any of the following circumstances:

- Contributions are made with a view to increasing the eventual benefits, and the lump sum was not actually used as the means to increase the contributions.
- The individual had no intention of using the lump sum in this way, but that changed and none of that was pre-planned.
- An inheritance or windfall is received before the contribution is made.
- The contribution is based on increased profits from self-employment or on a bonus from employment.

<u>Tax charges on death benefits or as a result of serious ill-health</u>

The special lump sum death benefit charge under Section 206 FA2004 will be at 45%, but from 2016/17 this is planned to change by adding the amount charged to income. This charge will apply only where the member at the time of their death was aged at least 75, and the lump sum death benefits are paid from 6 April 2015 -previously it was a charge at 55%.

Any lump sum death benefit listed below will be tax-free from 6 April 2015 where the member dies aged under age 75:

- A pension protection lump sum death benefit
- An annuity protection lump sum death benefit
- A drawdown pension fund lump sum death benefit
- A flexi-drawdown fund lump sum death benefit
- A defined benefit lump sum death benefit
- An uncrystallised funds lump sum death benefit

The serious ill-health lump sum charge under Section 205A FA2004 will be 45%. This charge will apply only where the member at the time the lump sum is paid from 6 April 2015 was aged at least 75 or older.

Any serious ill-health lump sum that is paid to a member under 75 will continue to be tax-free.

Small pots

From 6 April 2015 a payment of a small pot lump sum of up to £10,000 can be made from the age of 55 (previously it was 60). It will also be payable in the event of the ill-health condition being met.

Advising on the new regime

There will be free guidance available on the new options. This can be web-based, phone-based and face-to-face.

A levy will be charged to the pension providers to fund the work of organisations such as the Money Advice Service and the Pensions Advisory Service.

Tax advisers must be careful not to provide what could be termed financial advice when discussing choices with clients where the tax aspects are clearly of vital importance.

*Article contributed by Gerry Hart*

## Payment on termination of healthcare scheme was employment income

*Summary - The FTT found that a payment made on the termination of membership in a healthcare scheme was employment income.*

Mr Forsyth had retired from Nestlé UK in 1995. Prior to his retirement, he had been a member of its healthcare scheme. It was agreed that he would continue to benefit from the scheme in consideration of a contribution. In 2009, Nestlé offered Mr Forsyth the opportunity to leave the scheme in return for a one-off payment of £29,783. Mr Forsyth accepted the offer under a compromise agreement. Nestlé made the payment after deduction of income tax.

Mr Forsyth contended that the payment was capital; and, in the alternative, that it was a termination payment, so that the first £30,000 was exempt (ITEPA 2003 s 403(1)).

*Decision:*

The FTT observed that the compromise agreement could be a 'scheme' for the purpose of ITEPA 2003 s 393A(3). The issue was therefore whether it could provide a 'relevant benefit'. The FTT found that the lump sum had been paid to Mr Forsyth in connection with past services; as such, it fell within s 393B and was a 'relevant benefit' provided under an employer-financed retirement benefits scheme. It must therefore be taxed as employment income.

**Comments -** This case is a reminder that the scope of ITEPA 2003 s 393A is very wide, encompassing situations such as this one, which at first sight do not seem to involve a retirement benefits scheme.

*Graeme Forsyth v HMRC [2014] UKFTT 915*

## Company car made available under a maintenance package

*Summary - The FTT found that the use of a company car was not taxable as a benefit in kind.*

Shortly after joining the company, Mrs Gibson married its director. She had been provided with a car and fuel was paid for from her husband's personal bank account. The marriage had then broken down in 2009. She had stopped working for the company but had continued to receive a salary until her 'employment' ceased in March 2012.

Mrs Gibson had filed a tax return for the year 2010/11 without declaring any benefit from her employment. HMRC had then received the company's end of year details of pay and tax, including car benefits, and issued new assessments.

Mrs Gibson contended that her ex-husband had told her that the car was no longer a company car and that he had paid for repairs out of his personal bank account. She further argued that these 'benefits' were not provided by the company, but were part of a maintenance package agreed with her husband and confirmed by court order following problems with the payments.

*Decision:*

The FTT noted that the court order supported Mrs Gibson's contention that she received the car, not as an employment benefit but as part of a maintenance package. Furthermore, maintenance payments under agreements or court orders are outside the UK tax system. This means that payments are made without deduction of tax and that the recipient is not taxed on the receipts. The benefits received from the company must therefore be treated as income in the hands of Mrs Gibson's ex-husband and taxed accordingly.

**Comments -** Although the FTT accepted that the car was part of Mrs Gibson's remuneration package as an employee, it found that the maintenance agreement took precedence.

*Samantha Gibson v HMRC [2014] UKFTT 935*

## NIC records – Insufficient evidence of further contributions

*Summary - The FTT found that it could not infer the existence of NIC payments in the absence of records.*

Mr Plant is retired and lives in Australia. As he was not in receipt of a full state pension, he contacted the Department for Work and Pensions (DWP) in September 2012. The DWP sent him a list of all the NIC contributions shown on his record for the period 1963 to 1991. Mr Plant responded that some periods had been omitted. Mr Plant's file was then passed to HMRC, which was unable to resolve the issue by tracing any further contributions and issued a further schedule of NIC payments. On review of the case, the officer responsible traced a further 13 NIC payments which she included in Mr Plant's records.

Mr Plant contended that the tribunal should contact his former employers to obtain the relevant records. The FTT observed, however, that it was for the parties, not the court, to make requests to third

parties. The FTT also rejected Mr Plant's contention that the burden of proof should lie with HMRC, as it would have received the NIC payments. Although the FTT had some sympathy for the argument, it observed that the onus lies on the appellant to satisfy the tribunal upon sufficient evidence that the decision appealed was erroneous (Social Security Contributions (Decisions and Appeals) Regulations, SI 1999/1027).

*Decision:*

The First-tier Tribunal sympathised with the taxpayer but said the onus was with him to provide evidence that the decision appealed against was wrong (Social Security Contributions (Decisions and Appeals) Regulations, SI 1999/1027). Given that HMRC had managed to trace 13 additional contributions, the tribunal considered whether, as a result of the unreliability of HMRC's records, it could be inferred that contributions had been made for all the missing periods. On balance, the judge decided that there was insufficient evidence to establish this was the case. The taxpayer's appeal was dismissed.

**Comments -** This case may be relevant to any situation where the taxpayer has to rely on HMRC's records over a long period of time. It confirms that in the absence of records, the FTT will not infer their existence from HMRC's unreliability as a record keeper.

*James Plant v HMRC [2014] UKFTT 911*

## Who owns the shares? – Taxation of jointly held assets

*Summary - The FTT found that the taxpayer was liable to income tax on all the dividends paid on shares he owned.*

Although Mr Rowe was entitled to 50% of the dividends paid by CBF Capital Ltd (CBF), a company in which he was a director, he had only declared 25% of the dividends on his tax return, on the basis that his wife was the beneficial owner of the other 25%. The statutory financial statements of CBF stated that the shareholding of the company was 100% owned by its directors, yet Mrs Rowe had never been a director. The statements were signed by Mr Rowe.

*Decision:*

The First-tier Tribunal noted that the statutory financial statements for CBF for the year ended 31 March 2007, which he had signed, showed that the taxpayer held 50 shares. No mention was made of the taxpayer's wife. The equivalent statements for the year ended 31 March 2008 did not specify the shareholdings but said the directors owned all the shares. The taxpayer's wife had never been a director of the company. The taxpayer said his signing of the statements was a careless mistake.

The tribunal concluded that it may have been the taxpayer's intention that his wife should own half his shareholding but he did not put this into effect until July 2009. The 2007/08 and 2008/09 assessments were correct.

The taxpayer's appeal was dismissed.

**Comments -** It seems likely that, as the FTT suggested, the decision to make Mrs Rowe a beneficial owner was motivated by tax purposes. This would have worked had the trust been set up on time. The tax provisions regarding the taxation of income and capital gains from joint holdings are not the simplest tax provisions but they have been around for a significant period of time and therefore can easily be identified not least from the HMRC website. It was clear to the Tribunal based on the facts of the split of the shares.

*Peter Rowe v HMRC TC4023*

## Bonus repayments and negative earnings

*Summary - The FTT found that a bonus repayment by an employee constituted 'negative earnings'.*

Mr Martin was an employee of JLT Risk Solutions (JLT) when the company decided that he should be induced to enter into a new employment contract which would include a mechanism to tie him in. This was achieved with the payment of a £250,000 bonus on entering into the new contract, together with an obligation to make repayment in certain cases of termination of employment — on a time apportioned basis over a five year period. The bonus was treated as an emolument subject to PAYE and NIC, so that Mr Martin received a net sum of £147,500. Mr Martin resigned from the company a few months later, becoming liable to the sum of £162,500.

*Decision:*

The first issue was whether the repayments made by Mr Martin resulted in the bonus not being earned. The FTT observed that the amount on which tax is charged is the 'net taxable earnings from an employment in that year' (ITEPA 2003 s 9). The FTT rejected contentions that the bonus payment was contingent and that it amounted to a payment on account, with the earning accruing over the five year period. The repayment did therefore not reduce Mr Martin's earnings for the year of payment.

The FTT went on to consider the amount of 'net taxable earnings' for the year of repayment. It struggled with the concept of 'negative earnings', as the 'principal focus of general earnings is on something which an employee receives from the employer'. It found that a payment made by an employee can be brought into account in determining taxable earnings under ITEPA 2003, but only if this was also the case under ICTA 1988; ITEPA 2003 had not brought any change in the law. The correct tax treatment of the payments made pursuant to the employment contract must therefore be ascertained. The FTT found the payments were made pursuant to a 'straightforward contractual provision to restore to JLT part of that which it has paid for a commitment it will not in fact receive in full'; they did not constitute damages for a repudiatory breach. Consequently, the payments reduced Mr Martin's employment income in the repayment year to a negative figure and he could claim relief for the loss.

**Comments -** Bonuses which are contingently repayable have become increasingly common, particularly in the financial services industry. This case will therefore bring a measure of confidence to many employers. However, the UT stressed that its conclusion was firmly based upon the interpretation of the

contract. It may therefore be that past bonuses paid under differently drafted contracts will produce different results. Going forward, this case provides a useful example of good employment contract drafting — until HMRC publishes some much needed guidance.

*HMRC v Julian Martin [2014] UKUT 0429*

Note: HMRC will not be appealing the decision in Julian Martin on bonus clawbacks

## Pointless exercise determining distinct break as preliminary issue

*Summary – The Tribunal confirmed that the determination of a distinct break in a residence case needed to be examined as part of the appeal on the residence issue*

In an application for a preliminary hearing, the First-tier Tribunal was asked to decide whether the taxpayer was UK resident in 2007/08.

The facts were that the taxpayer left the UK on 2 April 2006, telling HMRC that he was going to work overseas. He did not return to the UK at all in the year 2006/07 and HMRC accepted that he was non-UK resident for that year. In 2007/08, the taxpayer worked in the UK for 71 days, leading HMRC to say he would be considered resident in the UK for that year.

The taxpayer appealed, claiming that he had made a distinct break from the UK by working full time abroad in 2006/07, and therefore his non-UK residence status should continue into 2007/08. He cited the decision in Reed v Clark [1985] STC 323 as the authority for his assertion.

*Decision:*

The First-tier Tribunal noted that HMRC had not made a final decision on the taxpayer's residence, but wished to ask him questions along the lines of the tests in R (on the application of Gaines-Cooper) v CRC [2011] STC 2249. This implied that HMRC were not contending that the taxpayer was precluded from saying that he had made a distinct break, as a result of having conceded in the form P85 that he did not intend to live outside the UK permanently.

The judge said it was unlikely that the distinct break point could be established solely on the basis of a year's total absence from the UK. Furthermore, HMRC had said that the test of residence would not be influenced by a decision of the distinct break issue. The taxpayer had not brought any evidence to support his claim, other than the fact he had not set foot in the UK in 2006/07. The judge said it would be “futile” to hold a preliminary hearing to hear the issue. The arguments should take place in the substantive hearing.

The taxpayer's application was dismissed.

**Comments –** As we see more and more cases coming before the Court system about residence before April 2013 it demonstrates the importance of having specific statutory rules (which we have had since 6 April although it will be January 2015 before the first tax returns using the new rules will be filed).The taxpayer was unsuccessful because the issue was not one that needed to be dealt with as a preliminary issue. This case confirms that under IR20, a multi-factorial approach must prevail when establishing residence. The new statutory residence test also refers to a multiplicity of factors.

*D Healey v HMRC TC4004*

## Update on fixtures deductions in buy to lets (Lecture P862 – 12.22 minutes)

Prior to April 2013, the landlord of a furnished residential property always had a choice when considering the available relief on furniture and equipment: he could claim the renewals allowance, or he could claim a "wear and tear" allowance calculated as 10% of the rent he receives. Wherever possible the 10% wear and tear allowance was generally claimed.

The 10% wear and tear allowance is given to cover the sort of machinery and plant assets that would normally be provided in furnished accommodation. These are things like:

- movable furniture or furnishings, such as beds or suites,
- televisions,
- fridges and freezers,
- carpets and floor-coverings,
- curtains,
- linen,
- crockery or cutlery,
- machinery and plant chattels of a type which, in unfurnished accommodation, a tenant would normally provide for himself (for example, cookers, washing machines, dishwashers).

This list is not meant to be complete but gives an idea of the assets the wear and tear allowances covers.

If the property was not fully furnished (e.g. kitchen appliances only), then the wear and tear allowance is not available. The renewals allowance would be the only option for a partly furnished property.

The renewals allowance works on the basis that you cannot have a deduction for the first purchase of an item of plant, so when fitting out a new rental property, there is no deduction for buying, say, a cooker. When the cooker needs replacing, however, the cost of the replacement can be claimed as a "renewal".

HMRC now state that the renewals basis will not apply to expenditure replacing plant etc which is incurred:

(a) on or after 6 April 2013, for the purposes of income tax; and

(b) on or after 1 April 2013, for the purposes of corporation tax.

From April 2013, it would appear that the only relief available to residential landlords will therefore be the wear and tear allowance, and this can only be claimed for fully furnished properties, so landlords of unfurnished residential accommodation will not be able to claim any relief at all for replacing such items as cookers, fridges, dishwashers, and so on.

There is an alternative argument that maintains that cookers etc would qualify as "trade tools" under s.68 ITTOIA 2005 or s.68 CTA 2009 and are therefore still deductible under statute rather than the renewals basis. The case of Caledonian Railways established that rolling stock could be treated as "trade tools" so is it reasonable to extend that argument to fridges and cookers in a partly furnished buy to let?

Due to the uncertainty in this area, a joint letter was sent by the Private Client Committee of the ICAEW Tax Faculty and the Property Taxes Sub-Committee of The Chartered Institute of Tax to HMRC in February 2014 asking whether s.68 extended to white goods etc in a partly furnished property.

HMRC replied in April 2014 and elements of their reply were encouraging . In their reply HMRC did confirm that the more expensive built-in appliances are regarded as fixtures and are hence deductible when replaced under the normal fixtures rules i.e. replacing a fixture without improving it beyond its original condition.

It is open to interpretation as to what constitutes a built-in-appliance – for me it must be embedded in the structure of the property. I would regard a cooker fitted in the kitchen units as a fixture (deductible when replaced) whereas a washing machine in a space under the units would not be (no deduction when replaced). The fact that the washing machine is plumbed into the water supply does not make it a fixture for me.

In their April 2014 reply, HMRC also confirmed that s.68 does not give an alternative deduction for free standing appliances, curtains and carpets. It would however appear that smaller items which are regularly replaced e.g. toaster, crockery, cutlery, tin can opener etc do fall within s.68 as "trade tools" and are hence deductible where the client is not claiming the 10% wear and tear allowance. Where the client is claiming the wear and tear allowance then the allowance covers the renewal of such items.

Furthermore, if the client is claiming the wear and tear allowance it would be reasonable to assume that the replacement of built-in appliances (ovens, fridges etc) is deductible in full when replaced i.e. they fall outside of the wear and tear deduction as they are regarded as fixtures.

It should also be noted that we should only claim for repairs of movable items such as furniture if you are not claiming the wear and tear allowance. If you are claiming the wear and tear allowance on a furnished property then the repairs are already within the allowance i.e. "tear".

And finally what do we do with replacement carpets and curtains?

It should be accepted that carpets and curtains are not fixtures. Consequently if the property is furnished and the wear and tear allowance is being claimed then no deduction is available for the repair or replacement of carpets and curtains.

If the wear and tear allowance is not being claimed e.g. partly furnished property, then the repair of carpets and curtains would be deductible. Generally their replacement would not be deductible UNLESS their replacement constituted a repair!

For example, if a carpet in reasonable condition was damaged it might be very difficult to repair it – so it ends up being replaced in order to repair it. The replacement is arguably deductible as a repair as that was the primary purpose of the spend. If however the carpet was being replaced because it was old and frail then the replacement would not be deductible.

*Article by Dean Wootten*

## Tax planning strategy in anticipation of retirement (Lecture P864 – 15.38 minutes)

Introduction

You should always attempt to create a strategy which reflects the personal and financial circumstances of the particular client. This ensures that you will neither waste a lot of time nor create a strain in your relationship with the client in making recommendations which greater knowledge of the client's beliefs and aims would have told you would not be regarded as realistic or acceptable to that client.

Having said that, it is no easy task to create a strategy for an individual in or close to retirement as circumstances can differ greatly and requirements can change. The reality may well be that a strategy will be agreed but then over a number of years it is overlooked and not reviewed, with the result that tax planning recommendations return to being made using a scatter-gun approach. That situation should be avoided at all costs.

There is no doubt that the economic difficulties faced by most people in recent years fell disproportionately on the retired or those anticipating retirement. They normally have limited scope for improving their investment income, which is subject to a substantial reduction in most cases, and they face increased costs on everyday items which usually increase at a rate in excess of the RPI or CPI. This must be fully taken into account.

In retirement tax should be regarded as an expense which, like most of them, can be reduced in the right circumstances. The benefits of doing so are likely to be greater than for younger individuals.

Factors to consider

In creating a tax planning strategy in anticipation of retirement you should always take into account all of the following, with the importance of each varying between clients:

- sources and certainty of the wealth
- planned retirement date
- current and future net spendable income requirements
- the family
- health
- capital resources
- flexibility
- client views on tax mitigation schemes
- client views on inherited wealth
- plans on where to live in the future
- client fears

Possible approaches in a variety of circumstances

A person approaching or in retirement could perhaps consider creating taxable income just short of the 40% tax band. That starts at a reduced level of taxable income of £31,865 for 2014/15 which is reducing to £31,785 for 2015/16. The gross income level before the 40% rate applies is £41,865 in 2014/15 and £42,285 in 2015/16.

Then, any requirement for income in excess of that can be created (if there is sufficient capital) from the following:

- investment bonds with a 5% annual tax-free withdrawal facility (so if need £50,000 and taking the 40% band as starting at gross income of £42,000, the extra £8,000 could be achieved by investing £160,000 in a bond and drawing 5% each year)

- investing for capital growth rather than income, and realising some capital at the required time

- sale of chargeable assets each year to create a gain within the CGT annual exemption, retaining funds equal to the gain and reinvesting the balance

A working shareholder could consider extracting available funds in retirement by way of dividends over a number of years, rather than closing the company down and paying CGT on distributions. By keeping total income to within the basic rate band, the extraction would involve no tax to pay.

Avoiding the personal allowance trap

There is a gradual withdrawal of the personal allowance if taxable income exceeds £100,000 via a reduction of £1 of allowance for every £2 of excess taxable income. This makes marginal income tax rates as follows for 2014/15:

| Taxable income | Marginal rate |
|---|---|
| £100,000 to £121,000 | 60% |
| £1201,001 to £149,999 | 40% |
| £150,000 + | 50% |

For 2015/16 the position is as follows, with the trap widening as a result of the increase in personal allowance. It is reckoned that some 500,000 individuals could be caught in this trap if they do not take avoiding action:

| Taxable income | Marginal rate |
|---|---|
| £100,001 to £120,000 | 60% |
| £120,001 to £149,999 | 40% |
| £150,000 + | 50% |

If taxable income is ordinarily in the 60% marginal band, consider pension contributions to reduce the income to £100,000 but only of course if the individual has earnings to cover. Other methods of avoiding the charge, depending on individual circumstances, include:

- Shifting income to a spouse or civil partner, via a transfer of assets
- Deferring income
- Gift Aid contributions
- Changing the accounting date for a sole trader or partnership
- Careful selection of the cessation date on retirement of a sole trader or partner

Get interest on deposits at the mortgage rate

To help a retired person's child or grandchild, and at the same time get an annual income advantage, the following idea is worth considering and may well be more realistic for the retired:

- Daughter has mortgage of say £200,000 and pays interest at 5%.
- Parents pays off £20,000 (10% which often is the maximum possible without a penalty being charged).
- Parents receive interest at 5% on the £20,000 from the daughter in place of the derisory amount they currently get from a deposit of £20,000.
- Daughter improves her mortgage rating by having a lower loan to equity ratio.

Offset mortgage

This could be arranged as a means of providing funds needed to meet living costs in excess of available income, or to provide flexibility. It is therefore often seen as an income top-up in retirement for those who are "asset rich but income poor". There is flexibility plus cost savings where funds are also held on deposit.

Typical aspects are:

- The main arrangement involves the borrower's finances remaining in separate accounts which are linked to the mortgage. The borrower sets his credit balances in savings and current accounts against the mortgage debt and only pays or receives interest on the difference. That creates a tax saving.
- Effectively the borrower's savings earn the equivalent of the mortgage rate, as in the previous idea.
- There is usually an arrangement fee.

Another arrangement involves a current account mortgage. This creates a financial pot which essentially is a current account with a large overdraft. All finances are kept together with a drawdown limit.

Get tax relief on a mortgage

This can work as under, but is an idea not specifically aimed at the retired:

- Husband has a £200,000 mortgage.
- He sells shares in his family company worth £200,000 to his wife.

- Wife borrows to pay for the shares under a commercial loan, and husband uses the funds to clear the mortgage.
- Tax relief claimable on the commercial loan as used to purchase an interest in a close company provided wife either owns more than 5% of the issued ordinary share capital, or owns some of the share capital and works for the greater part of her time in the management or conduct of the company.
- No CGT on the share sale as between spouses.
- Stamp duty payable of 0.5% on £200,000 = £1,000.

*Contributed by Gerry Hart*

# Capital Taxes

## Director remaining an employee after his resignation? (Lecture P865 – 8.04 minutes)

*Summary* - The FTT found that a director who had resigned from a company had, de facto, remained its employee.

Mr Hirst's 2009/10 self-assessment return recorded a disposal of shares and the CGT calculation included a claim for entrepreneurs' relief. HMRC disallowed the relief on the ground that Mr Hirst had not been an officer or employee of the company during the year prior to the disposal (TCGA 1992 s 169I(6)(b)).

Mr Hirst had been joint managing director of the company but had resigned from his position in December 2007 in order to control costs, as the company was in financial difficulties. He had continued to source new business for the company after his resignation. He had subsequently been arrested for a serious criminal offence; although he was eventually acquitted, this meant that he was unable to resume his position as a director of the company.

*Decision:*

The FTT observed that Mr Hirst's influence in the corporate governance of the company was commensurate with, but limited to, that of a significant shareholder. Although he was consulted, the decisions were made by the board and he was only able to make decisions as a shareholder. The FTT added that he had not been a shadow director either, as the board did not act in accordance with his instructions.

The FTT found, however, that an employment relationship had continued after Mr Hirst's resignation. He had played a crucial role in concluding deals and was entitled to a commission for his work — although he had never claimed it. He was also provided with a phone, a laptop and an internet connection by the company. Finally, he was under the control of the company. The criteria of Ready Mixed Concrete [1968] 1 All ER 433 were therefore satisfied.

**Comments -** This was a slightly unusual case, in that the appellant claimed to have been an employee. It is also a reminder that an employment relationship can exist in the absence of an employment contract, as a result of the circumstances in which work is carried out.

*Richard Hirst v HMRC [2014] UKFTT 924*

## Effect of IHTA 1984 s 8A election on legacies

*Summary - The Court of Appeal found that an election under IHTA 1984 s 8A could change the allocation of gifts under a will.*

The issue was the shares of the residuary estate of the testatrix, the late Valerie Smith, to which the Loring family and the Woodland Trust were respectively entitled. The will provided that assets or cash of

an aggregate value, equal to the amount of her unused nil rate band for IHT purposes at the time of her death, should be set aside out of her residuary estate and held for the benefit of the Lorings. The remainder of the estate was bequeathed to the trust.

At the date of the testatrix's death, the amount of her single unused nil rate band for inheritance tax purposes was £325,000. But for the changes introduced by FA 2008, the Lorings would have received £325,000 and the trust £355,805.

However, FA 2008 introduced IHTA 1984 s 8A which allowed the transfer of nil rate bands between spouses. As a result of a claim under s 8A by the testatrix's executors, her nil rate band was increased to £650,000. The Lorings therefore claimed to be entitled to £650,000, with only £30,805 going to the trust.

*Decision:*

The Court of Appeal dismissed the trust's appeal against the decision of the High Court. The Court of Appeal accepted that the testatrix cannot have had in mind the exercise of any discretion by her executors which would increase her nil rate band. However, she also did not have in mind a specific amount that she intended to pass to the Lorings and the effect of s 8A was that her nil rate band was increased retrospectively at the time of her death.

**Comments -** This case may become a precedent for similar cases to come. It is reasonably common for wills to refer to the testator's 'unused nil rate band'. The changes introduced by FA 2008 may therefore generate more litigation.

*The Woodland Trust v Loring [2014] EWCA Civ 1314*

## Issue of confidentiality

*Summary – The Court confirmed that the tax affairs contained privileged material*

The claimant, K, and the second defendant, A, were brother and sister whose father had bought a house in England in 1960. In 2007, their father died in Cyprus. Following his death, A instructed the defendant solicitor, H, to recover her share of the English estate.

An issue arose as to whether the property was part of the estate. In September, H was asked by the claimant to transfer the property into the claimant's name. This led to a potential conflict of interest between H's duty to act on behalf of A and his duty to act on behalf of the estate. In October 2010, he stopped acting for A.

K began proceedings against A and H, on the basis that he was entitled to the entire beneficial interest in the property and that it did not form part of the estate. A disputed this. She applied for an order that certain documents, including a letter to HMRC about inheritance tax, would not be disclosed.

The application was dismissed on that basis that where a solicitor acted for a beneficiary claiming under a will, legal advice privilege prevented disclosure. However, if the solicitor acted as a personal representative, the beneficiaries had a joint interest in the administration of the estate and legal advice privilege would be held jointly between them and could not be asserted by one against the other. A appealed.

*Decision:*

The High Court judge noted that the privileged information had come into existence in January 2007 when H had no role in the administration of the estate. A had been entitled to discuss matters with H, in the belief that they would be treated as confidential. It had not been open to H to decide that he was no longer bound by the duty of confidence to his client. Although K was entitled, as one of the beneficiaries, to know the circumstances in which inheritance tax had been paid and then reclaimed, the letter in question contained privileged material and should remain confidential.

The second defendant's appeal was allowed.

**Comments –** This case demonstrates the importance of the confidentiality of a taxpayer's affairs and the potential conflict of interest. It also demonstrates that whilst one party may be successful another party has different interests and the issues may be different.

*Kousouros v O'Halloran and another, Chancery Division*

# Administration

## No reason for delay in submission of returns

*Summary – The Tribunal confirmed the penalties as the delays were not acceptable for a professional adviser*

The taxpayers were the sons and executors of Mr Verdegaal. Form IHT200 was submitted to HMRC in August 2005. In March 2012, the Revenue issued trust and estate tax returns for 2008/09, 2009/10 and 2010/11. The deadline for receipt of the forms was 5 July 2012, but they were not submitted until March 2013.

HMRC issued late filing penalties and surcharges for the late paid tax.

The executors appealed. They said the deceased's affairs were complicated and it had taken a long time for the professional advisers appointed to sort them out. They were also waiting for HMRC to accept an amendment to the IHT200. Further, the executors had health difficulties and one of them lived in Tasmania.

*Decision:*

The First-tier Tribunal said the delays in the submission of the tax returns were not the actions of a "reasonable professional adviser". It also concluded that reliance on their accountant did not provide the taxpayers with a reasonable excuse for the late returns. The judge said: "whether or not to file a tax return by the due date is not a difficult technical issue … The deadlines are clear. The information is easily and publicly available on the HMRC website."

Finally, the judge said no special circumstances existed in this case: "The fact that a person's tax affairs are complex, that his health is poor, and/or that he lives abroad is not 'unusual or uncommon'; nor is it unusual or uncommon for there to be some temporary difficulty in finalising the figures for a tax computation, leading to the need to file provisional figures if a time limit is to be met."

The taxpayer's appeal was dismissed.

**Comments –** This case demonstrated delays which were completely unacceptable. The judge made comments which were self-explanatory in the circumstances as the excuses were pathetic. Such excuses as the judge stated are not unusual or uncommon and professional advisers have to deal with matters on an expedient basis.

*The executors of the estate of Simon Verdegaal v HMRC TC3994*

## Application to lift a bar to proceedings

*Summary - The FTT dismissed an application to lift a bar on HMRC from taking part in proceedings.*

Following a hearing in which BPP contended that HMRC had failed to provide further and better particulars of its Statement of Case in sufficient detail to comply with a direction issued by the FTT, the FTT had barred HMRC from taking any further steps in the proceedings relating to the appeal (under the Tribunal Procedure (FTT) (Tax Chamber) Rules, SI 2009/273, r 8(3)).

HMRC appealed to lift the bar, on the ground that the bar involved an unreasonable exercise of the FTT's discretion and was contrary to the overriding objective of dealing with cases fairly and justly. In particular, HMRC argued that the FTT should have looked at the substance of what had been provided and that the public interest required HMRC's continued participation.

*Decision:*

The FTT observed that it could only lift the bar if either the factual circumstances had changed since the imposition of the bar or there was an obvious error of law in the decision.

There was no change in circumstances. The question whether the FTT had wrongly found non-compliance with the direction was open for argument. The same applied to whether it exercised its discretion correctly. The application must therefore be dismissed.

**Comments -** The direction originally issued by the FTT provided that non-compliance could lead to the striking out of the proceedings and, arguably, HMRC had failed to comply. In the absence of an obvious error of law, HMRC could not have a 'second bite of the cherry' (in the words of Mr Grodzinski QC, counsel for BPP).

*BPP University College of Professional Studies v HMRC [2014] UKFTT 917*

## Reasonable excuse and late payment

*Summary - The FTT found that a company had a reasonable excuse for the late payment of PAYE.*

PSC's business was mainly photography for major high street retailers. In November 2011, it started work for TR Lewin on what was expected to be a lucrative contract. The main work was due to start in February 2012, but TR Lewin first postponed to May 2012 and then decided to end the project altogether. This was a major setback for PSC, which had retained staff since February 2012 for the purpose of the project. PSC eventually won another lucrative contract six months later, but the loss of the TR Lewin contract had an adverse short-term effect on its cash flow.

At the same time, PSC's bank abruptly changed its banking arrangements, reducing the company's overdraft facility from £125,000 to £90,000 and demanding monthly payments of £10,000. As the company was unable to make the payments, the overdraft facility was cancelled. This represented an unexpected financial strain for PSC.

PSC was late in its PAYE payments and incurred penalties. The issue was whether its circumstances amounted to a reasonable excuse.

*Decision:*

The FTT observed that PSC had made the payments as soon as it was able to do so and that its cash flow difficulties had prevented it from making payments on time.

Furthermore, it was clear that the cancellation of the TR Lewin contract and the bank's change of arrangements were the direct causes of PSC's cash flow problems; and it had not been unreasonable of PSC not to expect these problems. The FTT concluded that PSC had established a reasonable excuse.

**Comments -** Decisions in which appellants successfully argue reasonable excuse are few and far between. It seems that the fact that the company was able to point to two very specific and highly unexpected events was very helpful to its case.

*PSC Photography v HMRC [2014] UKFTT 926*

## Reasonable excuse and ignorance of the law

*Summary - The FTT found that the taxpayer's ignorance of the law was not a reasonable excuse.*

FA 2004 imposed a charge to income tax on a member of one or more registered pension schemes in respect of certain 'benefit crystallisation events'. Schedule 36 provided for transitional provisions which allowed for protection from the 'lifetime allowance charge', provided that notice was given to HMRC by 5 April 2009.

Mr Hargrove was a member of the Citibank and NatWest Markets pension schemes, having worked for both companies. Although he had never worked in pensions or taxation, he had a good understanding of corporate affairs and prepared his own tax returns. He had been aware of the new lifetime allowance charge; however, he had thought that it did not apply to him as he had deferred benefits and was no longer in employment. He also did not know about the possibility of making a claim before the 5 April 2009 deadline.

In 2012, he had eventually found out by accident (as a result of a conversation with a friend) about the possibility of opting out. He had immediately submitted a claim.

*Decision:*

The FTT found that a reasonable taxpayer in the position of Mr Hargrove would have contacted the scheme administrators or a professional adviser or would have searched HMRC's website to satisfy himself that the changes did not apply to him. Mr Hargrove therefore did not have a reasonable excuse.

**Comments -** Interestingly, the FTT accepted that a taxpayer's ignorance of a 'nuance' of the law may constitute a reasonable excuse. This was not the case here, however, as the taxpayer should have

displayed more 'curiosity'. This is not the first case where taxpayers have not realised the rules relating to protection and it may not be the last. With the massive changes about to occur next year in April 2015 taxpayers will need to be more aware of pension rules or they are likely to be more cases before the Courts.

*Michael Hargrove v HMRC [2014] UKFTT 921*

## Quantum of claim decided at prior hearing

*Summary - The FTT found that HMRC must repay the amount decided by the FTT, regardless of the fact that the taxpayer was not entitled to it.*

Following a first hearing in front of the FTT, Lady Pearson had become entitled to recover £40,233 under VATA 1994 s 35, on the basis that she had undertaken a residential conversion under the DIY housebuilders scheme.

However, HMRC only refunded £12,591, contending that the liability to refund VAT under s 35 applied only to VAT properly chargeable and that the suppliers should have charged VAT at 5% rather than the full rate. HMRC therefore refunded 5%, suggesting that Lady Pearson should recover the balance from her suppliers, who by now would be unable to obtain a refund from HMRC.

*Decision:*

The FTT observed that it would have been perfectly possible for HMRC to have raised this argument at the first hearing. This would have enabled the FTT to deal with the issue and the taxpayer to make protective claims against her suppliers — who may have been in time to make protective claims against HMRC. The FTT added that the taxpayer had won her appeal and was therefore entitled to the claimed refund of £40,233. The issue had been litigated and the fact that the recoverable amount should have been 5% did not change the position.

**Comments -** The case is interesting for two reasons: firstly, because the FTT found in favour of the taxpayer even though she was not entitled to the claimed refund; and secondly, because the FTT pointed out that in many cases the prospect of the appellant recovering excess consideration from a supplier should be taken into account when considering whether the provisions on refunds are fair and reasonable.

*Lady Henrietta Pearson v HMRC [2014] UKFTT 890*

## Validity of a discovery assessment

*Summary - The FTT found that a discovery assessment was valid.*

Mr Price had claimed £70,000 share loss relief under ICTA 1988 s 574. HMRC had issued a discovery assessment denying the claim, on the ground that Mr Price's advisers had failed to disclose in his return that the relevant company was a subsidiary. Furthermore, Mr Price's bank account records showed

entries which exceeded his taxable income. Mr Price explained these corresponded to a loan but that he did not have the relevant documents, having fled Cyprus due to threats from a business rival.

*Decision:*

The FTT found that HMRC had been correct in denying share loss relief on the ground that the company had been a subsidiary. The FTT also found that Mr Price's advisers had represented that the company had been a qualifying company, when it was not. HMRC had, therefore, been entitled to issue a discovery assessment when that fact had become known to them.

Finally, in the absence of satisfying evidence provided by Mr Price, the FTT concluded that HMRC was entitled to treat the undocumented credits on Mr Price's bank account records as taxable income.

**Comments -** The appellant had contended that the discovery assessment was actually a time-barred enquiry, as it was not possible to verify which information had been at the disposal of HMRC at the time an enquiry was still possible. However, the FTT solely relied on the fact that the taxpayer's advisers had misrepresented the position.

*Russell Price v HMRC [2014] UKFTT 929*

## Reasons for third party notices

*Summary - The FTT explained the circumstances in which HMRC can withhold the reasons for an information notice.*

Under FA 2008 Sch 36, para 3(3)(e), the tribunal can only approve a third party notice (i.e. a notice requiring the production of information on another taxpayer) if the taxpayer has been given a summary of the reasons for the notice.

*Decision:*

The FTT gave its conclusions on two points of law. The first point for construction was what reasons should be summarised and the 'shorter answer' given by the FTT was 'all of them'. The FTT stressed that it is not appropriate for only the most important reasons to be summarised. Similarly, it is not appropriate to exclude reasons for confidentiality purposes, unless a proper dispensation has been obtained (under para 3(4)).

The FTT then explained that for a dispensation to be granted under para 3(4), the tribunal only needs to be satisfied that there is a real risk of prejudice to the system of administration and collection of tax. However, where the reasons arise from intelligence obtained by HMRC from a 'suspicious activity report' (prepared by accountants, solicitors or banks) under the Proceeds of Crime Act 2002, HMRC may be bound by confidentiality and will only be under the obligation to disclose reasons which arise as a result of enquiries triggered by the report.

**Comments -** This decision may provide some clarification to taxpayers who do not understand why HMRC is not more forthcoming with the reasons behind the issue of certain information notices.

*HMRC v Ex parte a taxpayer [2014] UKFTT 931*

## Late trust return – Lack of reasonable excuse

*Summary – The Tribunal confirmed that there was no reasonable excuse*

The taxpayer was executor of an estate. He was sent a notice to file a trust and estate tax return for 2012/13 to be filed by 31 October 2013 if on paper, or by 31 January 2014 if filed online. No return was received so HMRC issued a late filing penalty. The taxpayer appealed saying he had written to HMRC in March 2013 to say no further income was expected by the estate. He also submitted the outstanding return on paper. This resulted in a further penalty of £400.

The taxpayer said he had a reasonable excuse for not sending the return on time. Several written questions to HMRC were outstanding or had not been responded to in detail.

*Decision:*

The First-tier Tribunal said, in light of the letter he sent to HMRC in March 2013, the taxpayer should have contacted the Revenue to see whether a return was required. There was no reasonable excuse for the delay.

The taxpayer's appeal was dismissed.

**Comments –** The taxpayer's excuse did not stand up to scrutiny. It would relatively easy to argue that information was required from HMRC and then utilise the delays as a reasonable excuse. The judge's comments are therefore self-explanatory.

*J Groves v HMRC TC3974*

## Ulterior motive by HMRC not proven

*Summary – The Tribunal confirmed that a notice by HMRC was valid despite suspicions of a taxpayer*

The taxpayer was a taxi driver. She appealed against a notice issued under FA 2008, Sch 36 para 1 requiring her to provide certain documents. Her adviser said the request had been made to enforce a business records check because the taxpayer had not co-operated when HMRC proposed such a check. He further claimed that the purpose of the check was to identify taxpayers for further investigation. This made the notice unreasonable.

*Decision:*

The First-tier Tribunal ruled that the notice was valid. There was no proof that HMRC had an ulterior motive in issuing it and, even they had, it was by no means certain that it would invalidate a subsequent notice. However, the tribunal considered the question "what do you do with the monies at the end of the working day?" to be unreasonable, saying the relevant issue was what the takings were, not what the taxpayer does with them. The taxpayer's appeal was dismissed.

**Comments –** The decision and the comments in this case are worth noting – despite the suspicions of the taxpayer that HMRC had ulterior motives behind the notice the Tribunal did not regard that as a valid reason for denying HMRC the opportunity to check into the taxpayer's affairs.

*C Jordan v HMRC TC4010*

## Costs awarded to HMRC

*Summary – The Tribunal confirmed costs awarded to HMRC because of a fruitless appeal by the taxpayer*

The taxpayer, a company, appealed against an information notice issued under FA 2008, Sch 36 para 1 on the ground that the documents requested were subject to legal professional privilege.

The company withdrew its appeal shortly before it was due to be heard by the First-tier Tribunal. HMRC subsequently applied for costs of £1,598. They said the company had acted unreasonably in bringing the appeal and knew that, given that the advisers were not solicitors, its assertion that legal professional privilege applied would be rejected on the basis of the Supreme Court's decision in R (on the application of Prudential plc) v Special Commissioner [2013] STC 376.

*Decision:*

The First-tier Tribunal accepted HMRC's argument. The judge said the taxpayer and its adviser "knew from the outset that the claim to legal privilege was groundless and the appeal did not have any reasonable prospect of success". He awarded HMRC their costs of £1,598.

**Comments –** This case demonstrated that it is pointless for advisers to raise arguments which are or ought to be regarded as spurious to support an appeal. The judge's choice of words about knowing from the outset are very revealing.

*Taylor Made Consulting Ltd v HMRC TC4018*

## Thirteen year late appeal

*Summary - The FTT granted a striking out application and dismissed an application to appeal out of time.*

Mr Butt's appeal was 13 years late and so the issue was whether the FTT would grant permission for a late appeal.

Up to October 1999, Mr Butt had run a shop. He had then sold the business and moved to Pakistan. In January 2000, in the absence of VAT returns, HMRC had issued VAT assessments, which with interest accrued now amounted to £22,000. Mr Butt had only filed a notice of appeal in November 2013.

Decision:

The FTT found that even if it accepted that Mr Butt had been unaware of the assessment until HMRC commenced debt collection proceedings in 2007, there was still a delay of six years before a notice of appeal was filed. Furthermore, Mr Butt must have been familiar with the VAT system in any event. The FTT noted that the financial consequences of striking off his appeal would be very serious for Mr Butt, but this did not seem to have prompted him to take timely action; whereas HMRC had treated the matter as final over a decade ago. Finally, the case had very little prospect of success, as HMRC had discovered a gross takings discrepancy.

**Comments -** The amount at stake must have been huge for the taxpayer, yet the FTT found that it could not grant permission for an appeal which was 13 years late.

*Mr Assaf Ali Butt v HMRC [2014] UKFTT 955*

## Criminal conviction and proceedings in the tax tribunals

*Summary - The FTT found that a taxpayer who had been acquitted in the criminal court was not entitled to have his car restored to him.*

On 19 January 2009, Mr Ahmed's car was seized in Dover as it carried 1.9kg of heroin. Mr Ahmed was acquitted at the ensuing criminal trial and he asked for his car to be restored to him. The Border Force offered to restore the car on payment of £885 (representing 30% of its value).

Mr Ahmed is diabetic and partially blind. He had been a passenger and the car had been driven by a Mr Imran Khan. Mr Ahmed's account of the trip was riddled with inconsistencies. In particular, he contended that he had not been aware of the whereabouts of the car when travelling to Amsterdam to acquire the illegal drugs.

*Decision:*

The FTT explained that Mr Ahmed had been acquitted of being knowingly involved in the illegal importation of prohibited goods, as the jury was not satisfied beyond reasonable doubt that he was

guilty. The FTT was not bound by the jury's conclusion as it had to decide whether Mr Ahmed was guilty on a balance of probabilities.

The FTT, agreeing with the Border Control, found that Mr Ahmed had been at least very reckless as to whether Mr Khan was using his car to smuggle drugs. The appeal was dismissed.

**Comments -** This case is an interesting example of the way criminal and civil proceedings interact. A taxpayer can be acquitted in a criminal court and found guilty in the tax tribunals.

*Moazzam Ahmed v The Director of Border Revenue [2014] UKFTT 880*

## HMRC News

Draft Finance Bill 2015 clauses

The government will publish draft clauses to be included in Finance Bill 2015 on Wednesday 10 December 2014, in the week following the Autumn Statement. Consultation on this draft legislation will run until 4 February 2015.

Travel & subsistence consultation deadline extended

The government has extended the deadline on its consultation on a review of the tax rules on employees' travel and subsistence expenses until 31 January 2015. The original closing date was 23 October 2014. This review complements the current HMRC consultations on expenses and benefits and the Treasury's broader call for evidence on remuneration published on 18 June.

OTS issues report on UK tax competitiveness

The Office of Tax Simplification (OTS) has published its roadmap to improve UK tax competitiveness. The report looks at the ways government can make it easier for businesses to handle the admin burdens of being taxed in the UK, in comparison with other nations.

The OTS's work has focused on the administrative burdens imposed; and, having spent four months hearing views from businesses, advisers, representative bodies and HMRC frontline staff, the OTS's practical recommendations are laid out in the report. The report also draws on the OTS's wider researches, including drawing lessons from the tax systems of the UK's close competitors.

An HMRC spokesperson stated: 'The UK is already a competitive place for tax, making second place on the G7 list. However, the OTS has set out a number of recommendations to improve that and get us to the most competitive — in terms of admin burdens — in the G7. Those include looking at the computations for corporation tax, harmonising NICs and income tax, and improving digital offerings from HMRC.'.

Employment payment summary

HMRC have made some changes to the employment payment summary (EPS).

From October 2014 employers can indicate on the EPS the tax month the EPS credit should be allocated against, using HMRC's basic PAYE tools and commercial payroll software that has this functionality. Validations will make sure that tax months can be submitted only within the relevant dates. This means that an EPS credit and a full payment submission could both be related to the same tax month.

Another change will allow employers to submit a longer period of inactivity on one EPS. HMRC have increased the allowable period of inactivity to a maximum of 12 months to help reduce the administrative burden for employers.

National minimum wage

The rates of national minimum wage applicable to pay reference periods starting on or after 1 October 2014 are:

- the main adult rate (for workers aged 21 and over) is £6.50
- the rate for workers aged between 18 and 20 is £5.13
- the rate for workers aged under 18 is £3.79
- the rate for apprentices is £2.73

Scottish rate of income tax

The Scottish rate of income tax will be introduced from 6 April 2016.

It will be administered by HMRC as part of the UK-wide income tax system and applied to the non-savings income of those defined as Scottish taxpayers.

The definition of a Scottish taxpayer depends on where an individual resides, not where he works. Individuals who move around the UK without having an identifiable main place of residence for most of the tax year will need to count the number of days they spend in Scotland compared with the rest of the UK.

HMRC expect to contact individuals in autumn next year if their records indicate they are a UK taxpayer and their place of residence is in Scotland.

Further information, including relevant tax codes, will be issued in early 2016.

HMRC will tell employers whom they should treat as a Scottish taxpayer by identifying them with a Scottish tax code.

Employers will need to operate tax tables and perform a tax calculation appropriate to the Scottish rate of income tax set by the Scottish parliament.

Advance notice for Agents - Increases to the amounts collected by PAYE Tax code

HM Revenue and Customs (HMRC) is increasing the amount of debt that can be recovered through an employee's PAYE tax code each year. HMRC refers to this as 'coding out'.

This will be done by introducing a graduated income-based scale, which will apply if an employee has a primary source of PAYE income of £30,000 or more each year. There will be no change to the £3,000 limit for earnings less than £30,000.

The graduated scale is shown below:

| Annual PAYE earnings | Coding out limits |
|---|---|
| Up to £29,999.99 | £3,000.00 |
| £30,000.00 – £39,999.99 | £5,000.00 |
| £40,000.00 – £49,999.99 | £7,000.00 |
| £50,000.00 – £59,999.99 | £9,000.00 |
| £60,000.00 – £69,999.99 | £11,000.00 |
| £70,000.00 – £79,999.99 | £13,000.00 |
| £80,000.00 – £89,999.99 | £15,000.00 |
| £90,000.00 and above | £17,000.00 |

These changes will only be applied to unpaid Self Assessment (SA) and Class 2 NIC debts and Tax Credit overpayments.

The current £3,000 coding out limit will still apply for SA Balancing payments and PAYE underpayments.

Coded out debts with the new limits applied will be included in your client's Annual Coding Notice (P2) for 2015-16 and the first deductions from income will start in April 2015.

To ensure a consistent approach and to safeguard employees from excessive deductions from their pay, HMRC is extending the "Legislative 50 per cent overriding limit" to include all tax codes and not just K codes. This limits any deductions to a maximum of 50 per cent of an individual's relevant pay.

Changes to the filing and payment date on relevant property trusts

The information in guide IHT113 on filing and payment dates is incorrect for events arising on or after 6 April 2014. HM Revenue & Customs will update this guide as soon as possible.

The changes apply to all chargeable events arising on relevant property trusts on or after 6 April 2014.

When an event, on which Inheritance Tax (IHT) is payable, takes place on a relevant property trust, the date for filing the IHT return and paying the tax due has been changed to 6 months after the end of the month in which the charge arose. The change in the:

- filing date will affect all relevant property trusts
- payment date will affect relevant property trusts where the charge to IHT arises between 6 April and 30 September, where previously, the payment date was 30 April in the following year

For example, if the chargeable event takes place on 10 May 2014, the filing and payment date is 30 November 2014.

These changes were made as part of Finance Act 2014.

# Business Taxation

## Key tax issues when incorporating (Lecture B861 – 11.08 minutes)

As a general rule, when profits reach around £30,000, incorporation becomes an attractive proposition from a tax perspective. In addition, with the changes contained within the Finance Acts 2013 and 2014, where tax planning opportunities within partnerships and LLPs with corporate partners have been largely removed, now may be the time to consider incorporating these as well.

Cessation date

On cessation your client is taxed on their remaining profits less a deduction for any overlaps relief from start up. It is important to consider the timing of incorporation in order to minimise the tax on these profits.

With a 30th April year end and incorporation taking place on 31 December, then in the last year your client will be taxed on profits for the last 12 months to 30 April plus the 8 months through to cessation in December. Taxing twenty months profits in one hit may move your client into a higher tax bracket. By waiting until after the following 5th April, the profits are spread over two tax years when this issue may well be avoided.

Stock

Where stock is transferred, it is transferred at deemed market value or if your client prefers, they can elect to transfer at the higher of cost or consideration. Making the joint election will ensure that no additional profits are taxed on your sole trader client at 40%.

Capital allowances

Your client can elect for the assets to be transferred for tax at tax written down value. This would avoid any balancing adjustment in the sole trader's books and the assets would move to the corporate at the same value as it was recorded in the sole trader's records. But is this the best option?

Assets can be gifted to the company at market value which would crystalise a balancing adjustment in the sole trader's books and the assets would be recorded in the corporate at market value, the value to be used for subsequent capital allowance calculations. If this would result in a balancing charge then this route would only be considered if the client has unused trading losses to use up; unlikely if your client is incorporating.

Alternatively your client can sell the assets for an agreed price so transferring the assets at this value. Agreeing a price of say £1 will crystalise a balancing allowance in the sole trader's books with the corporate acquiring the assets for capital allowance purposes at £1. This route would enable profits on

cessation to be reduced so saving tax at the 40% rate in the sole trader's books rather than having higher allowances in the company being relieved at lower rate of corporation tax.

Capital gains aspects

Where assets are gifted, this will trigger a market value disposal of goodwill and property. Provided all assets are transferred to the company, then incorporation relief under s162 TCGA 1992 is available to set the gain against the base cost of the shares acquired. Transferring property will trigger a Stamp Duty Land Tax charge on the market value of the property.

Ideally any property would be kept out of the corporate and so your client may be looking to gift only the goodwill to the company. Again this will trigger a disposal at market value; any gain on the goodwill can be set against the base cost of the goodwill in the company with the gain ultimately being taxed at the company's tax rate of 20% with more tax to pay on extraction of the funds from the company. Although he gain is deferred, the tax on exit can be high.

Most traders incorporating today prefer a full value incorporation with no deferral reliefs in order to take advantage of entrepreneurs' relief:

- The goodwill value can be agreed with HMRC using Form CG34
- Provided your goodwill is not just personal goodwill, so you have staff and a recurring income base, you should be able to agree a reasonable valuation
- The sale creates a loan account balance in the company (DR Goodwill, CR Directors loan)
- The owner draws a salary equal to the personal allowance and tops up with dividends up to the high rate threshold
- Further money needed is taken 'tax free' from the loan account
- CGT is payable at 10% (entrepreneurs' relief available ) which is paid from the loan account

## Failure to provide monthly returns for sub-contractors under CIS

*Summary – The Tribunal found that the taxpayer had a reasonable excuse*

The appellant, a small jobbing builder, had a yearly turnover of around £17,000–£25,000. His accountant advised him to register for the Construction Industry Scheme ("CIS"). The appellant then employed substantial sub-contractors all of whom had certificates confirming that he need not deduct tax. In light of the appellant's failure to provide monthly returns even though no tax was due, HMRC issued three penalty notices for £41·13, £140 and £7,200 on the grounds that he was given adequate generic notices about the scheme and should have known that he needed to make the returns, and he did not have a reasonable excuse for not doing so.

The penalty for £7,200 was arrived at after HMRC mitigated the original penalty of £21,600 (calculated on the basis that as the failure to file returns had continued beyond 12 months, TMA 1970 s 98A(2)(b) provided a further penalty not exceeding £3,000. The penalty was calculated on an increasing tariff basis according to the number of offences within the 12-month-period. As there were eight periods, the penalty amounted to £21,600). The appellant appealed on the grounds that (i) HMRC should have agreed to the returns under Condition A of reg 9 of the Income Tax (Construction Industry Scheme) Regulations 2005, SI 2005/2045 as he had taken reasonable care to comply with TMA 1970 s 61, the failure to deduct was due to an error made in good faith and he held a genuine belief that s 61 did not apply to the payment; (ii) in any event he had a reasonable excuse, for the purposes of TMA 1970 s 118, because he properly relied on the advice of his accountant; and (iii) as the penalty of £7,200 appeared to have been assessed under TMA 1970 s 98A(2), it was incorrect as it represented the mitigation that HMRC would have given if the First-tier Tribunal found the £21,600 penalty to be excessive.

*Decision:*

A contractor's genuine belief that he was operating the CIS correctly as a result of advice given by an accountant could amount to a reasonable excuse under TMA 1970 s 118 for a failure to make the appropriate returns. In the present case HMRC should have applied Condition A of reg 9 of the 2005 Regulations.

The penalty of £7,200 had been incorrectly raised. The parties agreed that the penalty notice should have referred to the penalty assessed under TMA 1970 s 98A of £21,600 and that, if HMRC were to exercise their powers of mitigation, the overall penalty would be reduced to £7,200. However the full penalty amount could not be substituted for the mitigated penalty as the whole appeal had been based on that mitigated figure. As the specialist unit, it behoved HMRC to ensure they prepared the notices properly. Their policy required the First-tier Tribunal to decide on the correct penalty, after which HMRC would consider mitigation. The First-tier Tribunal had no jurisdiction to consider the mitigation of the penalty; that was a matter for the High Court through an application for judicial review. In the circumstances, the £7,200 penalty would be set aside.

In addition, a penalty of £21,600 represented a full year's profits for the appellant and in relation to his business was disproportionate, as was the mitigated penalty. All the penalties would be set aside and the appeal allowed.

Appeal allowed.

**Comments -** The Tribunal applied justice to the affairs of the taxpayer as the penalties were not properly applied to someone new to operating the CIS and the taxpayer had gross paid contractors. It is somewhat surprising that HMRC brought this case given the facts.

*Laithwaite v Revenue and Customs Comrs TC3879*

## Where are we with Dr Samadian and self-employed travel? (Lecture B862 – 7.11 minutes)

The recent Dr Samadian judgement has enabled HMRC to clamp down on the business mileage claims of the self-employed who have a home office and another place of business. Travel between these locations will not be deductible and as such the business mileage % might be lower than previously claimed.

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

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

The key seems to be “regular attendance” at another location. How regular is open to debate but I would work on the basis that two days a week is enough to interest HMRC. Any less regular then I think they might find it hard to apply Dr Samadian – but that is not to say they will not try!

Another area of concern is whether this case can be extended to property businesses. A property landlord based at home would do the vast majority of his work at his rented properties. As he attends the properties on a regular basis he would appear to be caught by this judgement. In my opinion, the Dr Samadian decision may restrict qualifying business trips to those between properties. Any travel to or from home is likely to fall foul of the Dr Samadian judgement. This would be especially so for furnished holiday lets as these constitute a trade and are more likely to be regarded as another place of business.

Consequently, practitioners preparing tax returns for property landlords will need to consider the Dr Samadian decision and decide whether their client is affected.

*Article by Dean Wootten*

## Company purchase of own shares –HMRC guidance (Lecture B863 – 8.14 minutes)

Ordinarily this would constitute a distribution equal to the difference between the proceeds and the original subscription price. The shareholder then pays income tax at a maximum rate which is effectively 30.55% for those with taxable income of at least £150,000 and that of course includes the gross equivalent of the distribution.

CGT treatment will usually create a lower tax liability, and with full entrepreneurs' relief the maximum tax is 10% of the first £10 million of lifetime gains (28% thereafter). This is increasingly far less than the income tax charge on a distribution, and it is therefore somewhat surprising that HMRC seemingly are increasingly relaxed about giving the necessary clearance. There are however some issues where they could not be said to be generous in interpreting the legislation.

To qualify for CGT treatment all of the following conditions have to be met by reference to the vendor under Sections 1033 to 1043 CTA 2010, with guidance from HMRC's Company Tax Manual at CTM17500 onwards and from their Help Sheet on Company Purchase of Own Shares:

- purchase is wholly or mainly for the benefit of the trade
- purchase is not part of a scheme to enable owner to participate in profits without receiving a dividend, or to avoid tax
- vendor UK resident in the tax year of purchase
- shares owned for at least five years but this includes ownership by spouse or civil partner by reference to shares transferred to the vendor; in addition the five years is reduced to three if inherited, with the deceased's ownership period also added
- vendor not connected with company immediately after the purchase; this involves not holding over 30% of issued ordinary share capital or of loan capital and issued share capital or of voting power, and in practice this means careful consideration of the position of associates which for this purpose excludes children (unless minors); brothers; sisters

Advance clearance is available under Section 1044 CTA 2010 so that Section 1033 applies to the buy-back, and at the same time Section 701 ITA 2007 clearance should be sought under the transactions in securities anti-avoidance provisions.

The benefit of the trade test should be satisfied in any of the following circumstances:

- buying out a dissenting shareholder
- a controlling shareholder retires to make way for new management
- a shareholder who provided equity finance wants to withdraw the finance
- a shareholder dies and the new owner of the shares does not wish to keep them

HMRC's comments on this are in *IRSP 2/82* and *Tax Bulletin 21.* Relevant points from these and other more recent sources include:

- Retention of a small sentimental stake is acceptable (say maximum of 5%). Although technically CGT treatment is available where the vendor is only substantially reducing his shareholding (so that he holds not more than 75% of the proportion he held immediately before the buy back), in many situations this would result in the trade benefit test not being met.
- Vendor could have a short-term consultancy with the company to ensure a smooth handover. HMRC nowadays seem to accept that staying on as a part-time employee does not mean that the "benefit of the trade" test is failed.
- All the requirements of the Companies Acts must be met. The prohibition on a private company providing financial assistance for such an acquisition no longer applies. There is also no longer any requirement for a company to have authorisation in its articles for a buy-back of its own shares, but the articles can prohibit or restrict it.
- The vendor could lend back some of the proceeds, but then the 30% connected persons formula may be a problem in which case a bonus issue could be made as a means of increasing the issued share capital before the buy back

Another possible solution, where the full proceeds cannot be paid in one go, is for the company to buy back the shares in stages, but then the trade benefit test may not be met. The alternatives are:

- Two or more separate purchases are made because of the company's cash-flow position. Payment is made in full on the contract dates. The 30% test therefore applies to the shares only, and not to the balance of the proceeds.
- A single unconditional contract is entered into, with multiple completion dates. The beneficial ownership of the shares passes at the date of the contract but the CGT liability may be payable earlier than would otherwise be the case and this could be before all the consideration has been received. In this arrangement, the vendor would agree to waive any rights to dividends etc from the date of the contract. A clearance application would be made under Section 1044 by reference to the single disposal. However, HMRC now seem to argue that under this structure the continuing connection test IS applicable notwithstanding the fact that the shareholder has disposed of his entire beneficial interest in all of the shares at the date the agreement is entered into. If this does become an issue the solution would be to redesignate the uncancelled shares as a separate class of non-voting shares.

Company law requires all of the consideration on a buy-back to be paid when due, with nothing left outstanding. HMRC accepts that where consideration is deferred under the terms of the contract until completion date, this requirement is met.

*Article contributed by Gerry Hart*

## Taxation of foreign holdings

*Summary - The CJEU found that the flat rate taxation of a holding in a foreign investment fund was a breach of the principle of free movement of capital, due to the lack of disclosure by the fund to the tax authorities of the country of the investor.*

The van Casters owned units in non-resident capital investment funds held on deposit with a Belgian bank. Because these investment funds had failed to observe certain disclosure obligations under German tax law, the Casters' holdings were taxed at a flat rate, regardless of whether the value of their investment had increased or decreased.

The issue was whether the disclosure obligations — which apply without distinction to resident and non-resident funds — are compatible with the principle of free movement of capital.

*Decision:*

The CJEU confirmed that the flat-rate tax was likely to deter taxpayers from investing in funds which did not comply with German disclosure obligations, for instance because they did not actively target the German market. The German provisions therefore constituted a restriction to the free movement of capital. Furthermore, the CJEU found that such restrictions could not be justified by the need to ensure effective fiscal supervision and effective tax collection, since they did not allow the taxpayer to provide evidence or information allowing him to prove his actual income. The CJEU added that exchanges of information between tax authorities could supplement any information provided by taxpayers and that this additional administrative burden could not justify a barrier to the free movement of capital.

**Comments -** This case may be relevant to any situation where a taxpayer is not able to benefit from the most advantageous tax treatment in relation to a holding in an investment fund, due to the lack of disclosure by the fund. It also confirms that a tax treatment which is identical for both domestic and foreign funds can actually be discriminatory.

*van Casters v Finanzamt Essen-Süd C-326/12*

## Definition of 'convertible securities'

*Summary - The FTT found that deferred shares were convertible securities.*

The shares in Mr Bruce-Mitford's company, VFB Holidays, were acquired by VFB Group in a share for share exchange. Mr Bruce-Mitford additionally acquired 270,000 deferred shares in VFB Group.

In the 2006/07 tax year, Mr Bruce-Mitford sold 310,000 ordinary shares. The issue was whether an income tax charge arose on the disposal of the shares on the basis that the deferred shares were 'convertible securities' (ITEPA 2003 s 436, as amended with effect since 1 September 2003).

*Decision:*

The FTT found that the deferred shares were 'convertible securities'. This was because the articles of the company made provision for the conversion of the deferred shares into ordinary shares. The deferred shares were therefore 'employment-related convertible securities' for the purposes of ITEPA 2003 ss 438, 439 and 440 and their disposal triggered a charge to income tax.

The FTT added, referring to Prince and Others [2012] UKFTT 157, that it did not have jurisdiction to decide whether HMRC should have adopted the concessionary practice set out in its manual (Employment Related Securities Manual at ERSM40040).

**Comments -** This case confirms that the 'new' definition of 'convertible security' is very wide and includes a re-designation in the articles of the company.

*Michael Bruce-Mitford v HMRC [2014] UKFTT 954*

# VAT

## Deregistration restriction

*Summary – The Tribunal confirmed that deregistration necessitated an application to HMRC*

After an HMRC investigation, the taxpayer, who ran a wine bar, registered for VAT with effect from 1 August 2001. In 2008, his turnover fell below the VAT registration threshold, so he stopped accounting for VAT but did not deregister. In 2012, HMRC raised estimated VAT assessments to collect the outstanding tax and these resulted in a county court judgment against the taxpayer.

The taxpayer appealed. He explained that the failure to deregister was because he was in dispute with his former accountant. He was also having trading problems which had caused him a lot of stress.

HMRC said the matter was “very simple”. The taxpayer had continued to make taxable supplies from 2008 and the earliest date from which he could now deregister was 12 January 2012.

*Decision:*

The First-tier Tribunal said the only issue it could take into account was the law. The fact that the taxpayer had experienced problems with his accountant and difficult trading conditions could not be considered.

On the facts, although the taxpayer may not have been liable to be VAT registered from 2008, he was entitled to be registered because he continued to make supplies. Therefore VATA 1984, s 13(1) applied and the earliest date from which he could deregister was 12 January 2012, the date on which the Revenue received the taxpayer's form VAT 7 request to deregister.

The taxpayer's appeal was dismissed.

**Comments -** Neil Warren, independent VAT consultant, said: “A business is entitled to deregister if it expects taxable sales to be less than £79,000 in the next 12 months (the threshold since 1 April 2014). It is unusual for a wine bar with overheads such as staff and premises costs to be trading below this threshold but it was apparently the case for Mr Smith. But the key message is that the earliest date of deregistration is when HMRC receive a VAT 7 form — there is no scope in the legislation to allow a historic date in the case of a business that is still trading.”

*Lincoln Smith v HMRC TC3949*

## Deregistration: planning tips and procedures (Lecture B865 – 15.28 minutes)

One of the VAT announcements in the Chancellor's annual Budget is to increase the registration and deregistration thresholds. These increases are based on retail price indexes, so the increase this year in both thresholds was a welcome £2,000:

- 1 April 2014 – increase in the registration threshold from £79,000 to £81,000
- 1 April 2014 – increase in deregistration threshold from £77,000 to £79,000

The increase in the deregistration threshold could possibly be good timing if you have identified clients who might be able to deregister on the basis of reduced business turnover.

Deregistering for VAT

If a business owner ceases to make taxable sales, ether because he has sold his business or ceased to trade, then he must deregister on a compulsory basis. The date of deregistration will usually coincide with the date of his final sale. This could produce a deregistration date in the middle of a month – not a problem, it just means the final VAT return for the business will cover the period from when the last quarterly (or monthly) return was submitted up to the final date of trading. (HMRC Notice 700/11, para 2.4).

Deregistration based on reduced turnover

The positive point about deregistration is that a business considers the deregistration threshold in relation to future sales. Example 1 shows a situation with a good outcome for the business in question.

Example 1

Betty and Bob Ltd offers standard rated training services to banks and insurance companies (i.e. customers with exempt activities that cannot reclaim input tax). The company's annual turnover is £140,000 and it has been VAT registered for 20 years.

On 30 April 2014, Betty celebrated her 60th birthday and decided to retire. This decision means that the company's annual sales in the next 12 months from 1 May 2014 will be £70,000 rather than £140,000. The company can deregister on 30 April 2014 on the basis that its annual taxable sales in the next 12 months will be less than £79,000. This is good news because it will improve the competitive position of the company by not having to charge 20% VAT on its sales.

Note – if the company worked for customers that were 'fully taxable' i.e. could claim input tax, then the deregistration strategy would not really be sensible.

A key point to remember is that deregistration based on future turnover is a 'voluntary deregistration' situation and can therefore only be requested from a current or future date. So if you have missed the boat and could have deregistered a client a year ago, it's a damage limitation job and you can only deregister him moving forward.

Post deregistration input tax and bad debt relief

In most cases, input tax cannot be recovered on purchase invoices dated or received after the date of deregistration. However, the legislation recognises that there will often be costs that arise after deregistration, particularly on accountancy or legal fees, that relate to the period when the business was registered. In such cases, a claim for input tax recovery can be made on form VAT427, as long as the supply in question relates to services (not goods) and is made within four years of the date the services were provided.

A key point with VAT427 claims is that they must be submitted with original tax invoices. As long as the claims are sensible and accurate, HMRC normally pay them very quickly.

Note – many advisers do not appreciate that form VAT427 can also be used to claim bad debt relief as well as belated input tax. So if a business accounted for output tax on a sale while it was registered, and the debt was written off after deregistration, then you can claim the VAT back on form VAT427 if you meet the usual conditions for bad debt relief (HMRC Notice 700/11, para 8.4).

Output tax on assets

An important point to remember is that output tax is due on most assets held by the business at the time it deregisters. The output tax liability extends to trading stock as well.

As a general principle, when a business closes down, one of two things tends to happen to assets on hand – they are either sold or taken into the private ownership of the sole trader or partner. If a business is deregistering based on reduced future turnover, the assets on hand are likely to continue to be used in the business, but an output tax liability still exists on the final VAT return because a deemed supply has taken place.

In the case of an asset sale to an unrelated party before deregistration, the output tax position will be very clear – the liability being based on the proceeds of the sale. However, if an asset is taken into the private ownership of the business owner, or continues to be used in the business after deregistration, then an output tax liability still exists, based on the open market value of the asset in question. The principle of open market value takes into account any depreciation, damage to the asset, loss in value due to obsolescence, general wear and tear.

There are a number of concessions that could reduce the final output tax liability, in some cases to zero:

- output tax is not due on assets where no input tax has been claimed. This means, for example, that a van bought from a private individual who is not VAT registered would not have an output tax liability if the business deregistered.
- no output tax is due on motor cars – unless the very rare situation exists that input tax has been claimed on the car when it was purchased by the business, very unlikely because of the input tax block on cars available for private use.
- no output tax is due on zero-rated stock or assets – good news for a grocer or shop selling children's clothes

The most important point to remember is that if the total VAT due on all of the stocks and assets is less than £1,000, then there is no output tax liability to declare. The unfortunate situation is where the output tax payable is just above this figure – it is payable on the full value of the assets held i.e. the £1,000 cannot be deducted from the final liability.

Change of legal entity

A common situation in business occurs when a sole trader takes on a partner or, more common in recent years because of favourable corporation tax rates, transfers to a limited company.

When a change in legal entity takes place, there are basically two options for the new owners – either to retain the same VAT registration number, or cancel the old VAT number and register under a new number.

The administrative procedures for retaining the old VAT number require the completion of form VAT 68 by the old and new owners.

In reality, the decision to retain a VAT number or apply for a new registration is likely to depend on the new owner's assessment of the risks involved. Basically, once the new owners agree to retain the same VAT number, they are taking over the potential VAT problems of the previous owners. However, there may be a positive side as well – because the new owners would also benefit from any VAT windfall relating to the old period.

Example 2

Mr Smith takes on Mr Jones as a business partner on 1 January 2014 and completes form VAT68 to retain the same VAT number. Six months later, a VAT inspection identifies underpaid VAT for June 2011 period, an amount of £10,000 being due.

In effect, Mr Jones and Mr Smith are equally liable to the VAT debt, even though it was relevant to the period when the business was wholly owned by Mr Smith.

*Footnote* – it is possible that a legal agreement may be in place giving Mr Jones protection against situations like the one mentioned in this example. However, Mr Jones' position would have been protected if he had insisted on a new VAT registration at the time when he became a partner in the business.

Deregistration procedures

A business can deregister by completing form VAT7 online, which deals with the risk that the form may go missing in the post. This is important because HMRC will only deregister a client when they receive the form. I have encountered situations in the past where accountants have submitted paper forms to HMRC to deregister a client and the form has got lost either in the post or some other point in its journey. When a new form is then sent to HMRC, possibly three months later, they will only deregister the client from the date the new form is received, not on a historical basis, if the deregistration request is due to reduced turnover i.e. voluntary deregistration rather than compulsory.

Final horror story

The case of Mollan and Co Ltd v HMRC did not produce a happy ending for the taxpayer.

The company deregistered in 2009 and excluded output tax on its final VAT return in relation to a property that it had bought in 2005, claimed input tax of £42,875 on the purchase of the property, and also made an option to tax election. So when it came to the final VAT return, the company should have paid output tax (through the stock and assets rules considered above) based on the market value of the property. It didn't. This valuation was £200,000 so the output tax assessment raised by HMRC was £30,000 (we had the 15% rate of VAT in 2009).

To rub salt into the wounds, HMRC also issued a careless error penalty of £4,500 against the company for the omission on its final return, based on a 15% penalty rate.

*Contributed by Neil Warren*

## Abusive VAT arrangement

*Summary – The Upper Tribunal confirmed that the tax mitigation scheme was an abuse of right*

The University of Huddersfield Higher Education Corporation acquired the leasehold interests in two derelict properties. It wished to refurbish them, but recognised that the input tax on the costs would not be recoverable in full because — being in the business of education — it was partially exempt. The taxpayer entered into a mitigation scheme, establishing a discretionary trust over which it had control of the trustees. The university waived the exemption and granted a taxable 20-year lease of the properties to the trust at a notional rent.

The trust also waived exemption and granted an underlease of 20 years, less three days, to the university at a notional rent. The university's subsidiary company, the University of Huddersfield Properties Ltd, which was VAT registered but not part of the university's VAT group, charged the university £3.5m plus VAT for the building work.

The university was able to collapse this arrangement at any point. It claimed the input tax.

HMRC disputed the claim on the basis that the lease and underlease were not effective for VAT.

The appeal went first to the VAT tribunal, which referred to the Court of Justice of the EU. After its decision (Case C-223/03) [2006] STC 980), the First-tier Tribunal allowed the university's appeal (TC2823). Applying the principles in CRC v Weald Leasing Ltd (Case C-103/09) [2011] STC 596, it concluded that the leaseback arrangement had not been abusive. HMRC appealed.

*Decision:*

The Hon Mrs Justice Rose DBE and Judge Greg Sinfield in the Upper Tribunal found that the tax mitigation scheme entered into by the university and the trust was an abuse of right.

This was because it entitled the university to claim more input tax paid on the refurbishment work than it would have been able to, had the work been regarded as directly and immediately linked to its general, largely exempt, supplies.

The judges decided the lease by the university to the trust and the underlease from the trust to the university should be disregarded. As a result, the refurbishment should be treated as undertaken for the university's general purposes.

HMRC's appeal was allowed.

**Comments -** According to the Revenue, the decision reinforces the use of the “Halifax abuse” principle — the result of a landmark legal ruling which recognised the EU principle of “abuse of rights” as applied to VAT (see Halifax plc v CCE (and related appeals) (Case C-255/02) [2006] STC 919).

Jennie Granger, director general enforcement and compliance, HMRC, said: “This case offers further evidence that HMRC pursue those who avoid tax and will not hesitate to litigate if a satisfactory settlement can't be reached through discussion. The Upper Tribunal's ruling also backs a key argument used by HMRC to tackle abusive VAT avoidance.”

*CRC v University of Huddersfield Higher Education Corporation, Upper Tribunal*

## Visit prompts submission of returns

*Summary – The Tribunal confirmed that the lack of submission of returns did not make a valid reasonable excuse*

The taxpayer had not submitted any VAT returns since he registered for VAT with effect from 29 June 2011. After HMRC contacted him in November 2012 to arrange a visit, he submitted the forms. He had in the meantime paid central assessments issued by HMRC for the outstanding periods, but these were much lower than the actual liability. The letter accompanying the central assessment instructed the taxpayer to send the return within 30 days of the receiving the assessment, stating that penalties would be imposed if he failed to do so.

HMRC issued penalties and the taxpayer appealed. He said he had a reasonable excuse for not submitting the returns because he had relied on his accountant.

*Decision:*

The First-tier Tribunal did not accept the taxpayer's excuse. The judge concluded that the returns were finally submitted only because of the pending HMRC visit.

The taxpayer's appeal was dismissed.

**Comments -** Neil Warren, independent VAT consultant, said: “It is important that returns are submitted by due dates, even if a taxpayer cannot pay the amount due on the return. In such cases, a request for time to pay which is accepted by HMRC's business payment support service will avoid a default surcharge on the unpaid tax, as long as the agreement is made before the return is legally due for payment. Too many taxpayers still wait until HMRC contact them about unpaid tax on returns, rather than seeking to arrange an agreement in advance of the payment date.”

*David Milner trading as Staffcall v HMRC TC3856*

## Letter can be a valid claim

*Summary – Making sure that you meet all the relevant conditions can validate a letter as a claim*

The taxpayers, Bratt Auto Services (BAS) and Bratt Auto Contracts (BAC), traded as a vehicle rental and self-drive company and a long-term contract hire company respectively. On 30 March 2009, the taxpayers' agent wrote on their behalf a letter to HMRC claiming a repayment of output VAT. HMRC said the letter did not constitute a claim. The taxpayers appealed.

*Decision:*

The First-tier Tribunal said the issue concerned solely the letter, not the claim.

On BAS's claim, the judge said the letter satisfied the conditions of reg 37 of the VAT Regulations because it stated the sum claimed (£1.29m), explained how the amount had been calculated and referred to the company's accounts in support. The demands of reg 37 were mandatory in the sense that they had to be met otherwise the claim would not be allowable for the purposes of VATA 1984, s 80.

However, the tribunal decided the claim did not need to refer to prescribed accounting periods, as asserted by HMRC, to meet the requirements of reg 37.

For BAC, the position was different. The letter did not include the amount claimed and therefore could not satisfy reg 37. It was more of a prospective claim than an actual one, with details to be supplied later. An unfortunate consequence of not having the required information to hand may lead to the claim being time barred under s 80(4).

**Comments -** Neil Warren, independent VAT consultant, said: “Issues relating to VAT overpayments can sometimes take many years to resolve, such as the recent issue of output tax being exempt or standard rated on golf club green fees, so it is important that a business makes an accurate protective claim to HMRC to protect the four-year error correction period. In some cases, HMRC will reject the claim, even if it has been correctly made, because they dispute the interpretation of the legislation in question, meaning that it will then be necessary for the business to make an appeal to the First-tier Tribunal, often standing behind a lead case.

"The other key point to recognise (and which was considered in this case) is that any amendment to an earlier claim can only relate to the issues within that claim. So if a claim was based on whether output tax was due on green fees for golf clubs, any subsequent amendment to the first claim could only relate to this particular point of principle — other amendments not linked to the original issue would mean a new claim has been made by the taxpayer, and the four-year cap would apply from the date of the new claim."

*Bratt Auto Contracts; Bratt Auto Services (TC3799)*

## Different rates permitted

*Summary – The ECJ ruled that EU legislation did not preclude national legislation subjecting books published in different formats to different rates of VAT*

The applicant, K, was a publishing company that produced general literature and textbooks on paper, and also audiobooks and ebooks. It applied to the Finnish tax board for a preliminary ruling to establish whether books published other than on paper could be regarded as books for VAT purposes and subject to a lower rate of VAT. The Finnish tax board ruled that only publications printed on paper or produced by comparable means could be regarded as books and that ebooks could not be subject to a reduced rate of VAT.

K appealed, and the matter was referred to the Court of Justice of the EU for a preliminary ruling.

*Decision:*

The ECJ ruled that EU legislation did not preclude national legislation subjecting books published in different formats to different rates of VAT.

**Comments -** Baker Tilly's David Wilson described the court's ruling as "an interesting development in the long-running debate on the discrepancy of VAT rates between printed books and ebooks". Noting that the EC had already taken infraction proceedings against Luxembourg and France for applying a reduced VAT rate to ebooks on the basis that they were electronic services, he added that the "latest intervention from the European court indicates that the principle of fiscal neutrality does not rule out a reduced rate being applied to ebooks. Namely, if what matters to the average consumer when buying a paper book or ebook is, in essence, the similar content of these books then, regardless of their physical support or characteristics, the selective application of a reduced VAT rate to printed books cannot be justified."

*K Oy (Case C-219/13), Court of Justice of the EU*

## Group reorganisations and Fleming claims

*Summary - The FTT found that the appellant's claims were time-barred.*

Taylor Clark had owned and operated bingo halls, cinemas and multi-use complexes since 1993. In 1990, Taylor Clark had incorporated a subsidiary, Carlton, to which it had transferred these businesses, together with the related assets and liabilities. Taylor Clark had been the representative member of the VAT group from 1973 to 2009. Carlton was a member of the VAT group from 1990 to 1998.

During the period 1973 to 1998, Taylor Clark overdeclared output tax, on the erroneous understanding that income from certain gaming and bingo machines was not exempt.

Carlton made four Fleming claims. The first claim was made in November 2007. HMRC made the repayment to Taylor Clark and then issued assessments to Taylor Clark for recovery of the sums paid. HMRC declined the three other claims.

*Decision:*

Agreeing with the FTT, the UT found that the claims were time-barred. It observed that Taylor Clark had made no claims prior to the expiry of the limitation period. The claims made by Carlton were not made on behalf of Taylor Clark and they had not been assigned to it.

The UT added that the 1990 agreement had not assigned to Carlton the right to repayment of overpaid output tax. In particular, the reference in the agreement to the transfer of 'all other sums owed' did not include debt owed by HMRC to any business of the group, as HMRC only owed debt to the VAT group as a whole. Furthermore, a reasonable person reading the agreement would not have concluded that Taylor Clark was assigning rights it held as representative member of the VAT group.

**Comments -** As a result of the decision, neither Taylor Clark nor Carlton will be able to recover the VAT wrongly paid. Group reorganisations can often lead to difficulties in ascertaining the entities liable to tax or entitled to refunds. In confirming that, unless specifically provided, a business sale agreement does not transfer rights against HMRC, the case brings some clarity.

*Taylor Clark Leisure v HMRC [2014] UKUT*

## TOGCs and Fleming claims

*Summary - The FTT found that the right to a VAT refund had passed to the transferee under a transfer of a business as a going concern (TOGC).*

Robert Cross had been retailing cars as a sole trader since 1977, when he decided to incorporate his business by transferring it as a going concern to a newly incorporated company in 1985. He applied for the relocation of his VAT registration number to the company. In March 2009, he claimed repayment of VAT wrongly paid (VATA 1994 s 80(1)) in relation to demonstrator, rental and courtesy vehicles covering the period from 1981 to incorporation.

A separate claim was lodged for the company for the period 1985 onwards. HMRC rejected the claim as sole proprietor for the period 1981 to 1985, on the ground that Mr Cross's right to make a claim had passed to the company as a result of the TOGC.

*Decision:*

The FTT accepted that Mr Cross had simply not thought of VAT issues at the time of the transfer. It also accepted that Midlands [2008] STC 1803 is authority for the proposition that a claim under s 80 is incorporeal moveable property which can therefore be transferred.

The FTT observed that when the business had been transferred, there had been no right to a VAT repayment, as such rights had been created later by FA 1989 s 24.

The FTT agreed with HMRC's general proposition that on a TOGC, all rights pass to the transferee unless otherwise specified. The FTT also referred to the fact that the statutory provisions deemed any tax paid by the transferor to have been paid by the transferee and s 80 refers to a 'person' who has accounted for output tax. That person was the company, which was the only taxable person in any event.

**Comments -** This case will be a useful reference to any situation where a Fleming claim concerns periods which pre-date a TOGC. It confirms that the transferee should make such claims.

*Robert Cross v HMRC [2014] UKFTT 907*

## Default surcharge and reasonable excuse

*Summary - The FTT found that the company had had a reasonable excuse for the late payment of VAT.*

Fogarty produces duvets, quilts, pillows etc. which it supplies to major high street companies. Fogarty was late in making a balancing payment (under the payment on account scheme) due on 28 March 2013.

Fogarty's finance director had written to HMRC explaining that the company was unable to make the payment on time but would pay by 15 May 2013. He explained that the company had secured a large new contract with a major retailer for quilts with low tog ratings. The retailer had then postponed the launch from March to May due to an unusually cold winter. The result was that the company had a large amount of working capital tied up in finished goods awaiting delivery and invoicing. Additionally, HMRC had rejected a time to pay proposal.

On 15 May 2013, Fogarty was only able to pay half of the balancing payment as a result of the deferral of major sales promotions by one of its customers. The payment was made as soon as practicable.

The issue was whether Fogarty had a reasonable excuse to avoid a default surcharge (VATA 1994 s 59(7)).

*Decision:*

The FTT referred to Steptoe 1992 STC 757 as authority for the proposition that an insufficiency of funds to pay VAT was not a reasonable excuse; but that the underlying cause of any insufficiency of funds, 'if entirely unforeseen and outside the control of the taxpayer, may constitute a reasonable excuse'. The FTT found that Fogarty had done everything it could to meet its tax liabilities, including liaising proactively with HMRC. It also rejected HMRC's contention that Fogarty's financial problems were attributable to the ordinary hazards of trade, noting that the company's cash flow problems had reached 'crisis proportions'. The FTT concluded that Fogarty had established a reasonable excuse. The appeal was, however, only allowed in part, as Fogarty had made other payments late prior to reaching time to pay arrangements with HMRC.

**Comments -** Interestingly, the FTT recognised that the company had taken a risk in accepting the contract, which had eventually led to dramatic cash flow problems. It stressed that risk was part of business and praised it for 'managing to trade successfully, during … the deepest and most challenging recession of the last half century'.

*Fogarty v HMRC [2014] UKFTT 936*

## Financial services and attribution of input tax

*Summary - The FTT found that VAT incurred in relation to the obtaining of banking deposits to finance investments was not recoverable.*

ING UK's business had two sides: investing deposited funds; and attracting and retaining deposits. The costs linked to the taking of deposits were very high (i.e. advertising, call centres, IT services and staff) and were (mostly) subject to VAT; whereas little expenditure was incurred on making investments and it was (mostly) not subject to VAT.

ING UK contended that some of the VAT incurred to support its deposit taking activities represented business overheads which were recoverable (under VATA 1994 s 26(2)(c)), because ING UK made specified supplies (VAT (Input Tax) (Specified Supplies) Order 1999 art 3(a)) when it made investments in non-EU issued financial instruments.

*Decision:*

The FTT found that ING UK provided a service to depositors. Although it did not offer walk-in branches, the services it provided were valued by depositors and went beyond what a mere borrower of money would provide to a mere lender. Furthermore, the services were provided for a consideration, namely the deposits themselves, under a contract for barter. The value of the supply must be calculated by what the bank was prepared to expend on providing those services.

The FTT concluded that the VAT incurred in making the supplies of banking services was not recoverable. It added that it was not incurred on the overheads of the business as a whole, as the direct and immediate link was to the banking services.

**Comments -** Attribution raises particularly complex issues in the financial services sector. This case clarifies two key points: offering deposit facilities — even with reduced services — amounts to the provision of banking services; and input tax must be attributed to the services to which it is most closely connected.

*ING Intermediate Holdings v HMRC [2014] UKFTT 938*

## Procedures followed

*Summary – Appeal by taxpayer who alleged she was never registered failed*

A business, The Good Food Company, was registered for VAT in the name of the taxpayer in May 2004. She claimed to have no knowledge of the application or the business. The company received about £137,880 in VAT repayments. Because they were unable to validate the repayments, HMRC raised assessments which would have largely cancelled out VAT repayments.

The taxpayer appealed on the basis that the registration was fraudulent and she had not been in business as The Good Food Company. HMRC accepted that her partner had completed the registration fraudulently without the taxpayer's knowledge but said the registration was valid.

*Decision:*

The First-tier Tribunal decided that HMRC were correct to register the taxpayer for VAT. The application included bank account details as well as other relevant details about the business, so HMRC had no reason to doubt that the VAT1 form was fraudulent. There was no statutory requirement for HMRC to carry out verification checks, nor was there any reason for their suspicion to be aroused. The tribunal suggested that, as a result of its decision, the taxpayer may wish to appeal against the assessments in a separate appeal.

The taxpayer's appeal was dismissed.

**Comments -** Neil Warren, independent VAT consultant, said: “This outcome has divided opinion among VAT consultants. The key thing is that the taxpayer received payments into her personal bank account from the business account of £35,000, which indicated she had knowledge about the registration, more than she admitted. In fact, the only credits into the business account over an 18-month period came from HMRC repayments. There was no indication within the bank statements that an actual business was being run; for example, there were no sales or lodgements relating to payment of suppliers. Overall, the facts in this case were exceptional, so I think the risk of a taxpayer suddenly getting a knock at the door from HMRC to ask questions about a VAT registration they know nothing about is very low. However, it might take another hearing to consider the separate question of whether Ms O'Ryan is liable to pay the VAT assessments issued by HMRC.”

*Oonagh O'Ryan v HMRC TC3956*

## New 2015 rules for e-service businesses (Lecture B865 – 15.28 minutes)

Important VAT changes will take effect on 1 January 2015 in relation to supplies of digital services (broadcasting, telecommunication and electronic services – known as BTE sales). The changes will affect all UK businesses that supply digital services to non-business customers in other EU countries ie B2C sales in VAT speak (business to consumer). The new rules have been described in some circles as the most radical changes since VAT was introduced back in 1973 and while I feel this is a bit of an exaggeration, they are certainly significant. The basic outcome is that VAT on these sales will be due in the customer's country rather than that of the supplier. In this session, I am not going to recap on the basic rules but look at one or two surprise issues that have emerged in recent months.

**E-gaming, financial services and training suppliers…….**

One point of principle to be aware of (not previously understood in many quarters) is that certain digital supplies are exempt from VAT in the UK but are standard rated in other EU countries. The reason this might be a surprise is because many advisers think that all countries in the EU apply the same rules when it comes to VAT exemptions (a level playing field) and while this is true in most cases, there are three trade sectors where there could be differences due to the fact that the VAT Directive gives some flexibility to Member states in the way they apply the exemptions:

- online gaming and betting industry
- financial services
- training services

In effect, the potential outcome of the new rules is that eg a UK e-gaming business might not currently have a VAT registration in the UK because all supplies are exempt (place of supply being UK) but then some sales could be standard rated in an overseas EU country when the place of supply moves to the customer's country with effect from 1 January 2015 if that country does not apply the same rules as the UK as far as the exemption is concerned.

*Practical example*

Let me explain the principles considered in the last paragraph with an example. Let us assume that Bet Ltd is based in the UK and is an online gaming business that has customers from across the EU. All of the customers are non-business and there is no doubt that online gaming is a digital service because it requires *minimal human intervention* and is heavily *reliant on the Internet* for its execution. Note my underlining and italic text in the last sentence – these are the key considerations to think about when deciding if any supply is an e-service. Bet Ltd is not VAT registered at the moment because all of its sales to EU based customers currently have a place of supply as the UK (where the supplier is based, the general B2C rule) and the legislation at VATA1994, Sch 9 , Group 4 means these fees are exempt from VAT.

However, the position changes dramatically on 1 January 2015. The place of supply for all sales will move to the customer's country in relation to B2C digital services if the customer is based in the EU and is not in business.

So as an example, if the legislation in Denmark says that supplies of online gaming are standard rated rather than exempt from VAT, then our UK business will need to account for 25% Danish VAT on all fees earned from Danish customers after 1 January 2015. Supplies to UK customers will still be exempt under Group 4 mentioned above. See Box 1 and Box 2, the latter gives HMRC's view on the situation.

**Box 1 – VAT liability of sales made by a UK online gaming business after 1 January 2015**

- UK customers – all income is VAT exempt
- EU non-business customers based in a country where online gaming supplies are also exempt – VAT exempt
- EU non-business customers based in a country where online supplies are not exempt – these sales will be subject to the standard rate of VAT that applies in that country eg 25% in Denmark. The tax will either have to be paid via a MOSS return submitted to HMRC or a separate VAT registration in that country.
- Customer is based outside the EU – sale is outside the scope of UK and EU VAT

**Box 2 – HMRC comment on online gaming issues (post event Q&A extract after conference in London) and 2015 changes**

Q18) It is my understanding that online gaming/betting companies may need to charge VAT if they happen to have any customers (players) established within an EU Member State that does NOT exempt online gaming / betting. This basically means that online gaming / betting companies will need to know whether the online gaming / betting service is VATable, or VAT exempt, in each of the 28 Member States of the EU and configure their systems and pricing accordingly. Is that the case?

A18) Yes. The intention is to make this information available later this year on an EU MOSS Web-Portal prepared by the European Commission.

**MOSS challenges……….**

Most UK businesses which have collected overseas tax from BTE supplies will declare it to HMRC by submitting a MOSS return on a calendar quarter basis (MOSS standing for Mini-One Stop Shop). The return will show each EU country and the amount of tax (in sterling) that is appropriate to each EU country for relevant supplies. The return will be submitted online and tax paid electronically in all cases (but not by direct debit) – the deadline date is the 20th day following the calendar quarter in question. HMRC will then pass on the tax to the Member state in question, after deducting a 30% commission in the first two years and 15% in years three and four (Note – these deductions are to help Luxembourg which will lose a lot of tax after 2015 because many big players who have set themselves up in the country to take advantage of the low 15% rate of VAT will be collecting overseas VAT after 2015 rather than Luxembourg tax ie based on the customer's location).

However, the main problem with a MOSS registration is that it can only be acquired by a business with a domestic VAT registration in its own country. So if I am in business selling computer software online to private individuals and am not VAT registered in the UK because my annual UK taxable sales are less than the registration limit of £81,000, how will I deal with tax due after 1 January 2015 in relation to B2C sales made in other EU countries? Unfortunately it seems that my only options are to either take an output tax hit on by domestic sales by getting a UK VAT number (so I can then apply for a MOSS registration) or instead get a separate VAT registration in each country outside the UK where I have some sales. Do not forget that when it comes to sales in other EU countries, there is a zero registration threshold – so £1 of BTE sales to non-business customers and you must account for overseas VAT!

**Other issues**

Here are a few other surprises (and tips) regarding the new system:

- Only a business can register for MOSS, not an agent acting on behalf of the business owner. But once the registration is in place, the agent can submit MOSS returns each calendar quarter on behalf of his client.
- MOSS returns can be amended if errors have been made that have resulted in an incorrect amount of tax being declared. The time period for adjustment is three years but this could be extended if the national legislation within the country where the error has been made allows adjustments for a longer period eg to four years in the case of the UK tax authorities.
- A business can now apply for its MOSS registration ie in advance of 1 January 2015 – so this session is good timing as a reminder to get things moving if you or your clients are affected by the new rules.
- If no relevant BTE sales have been made for a period, then a nil MOSS return must still be submitted by the registered business. This is different to an EC Sales List where nil returns are not necessary.
- If a customer in another EU country does not provide a VAT number, then the supplier of BTE services can assume that the sale in question is a B2C transaction and charge the rate of VAT that applies in that country.
- Where a customer has both a ‘permanent address’ and a ‘usual residence’ eg all of his post is sent to his main home in Manchester but he spends most of his time at his holiday villa in Spain, then it is the ‘usual residence’ that takes priority ie Spain in this example.
- A supplier of e-services will be unaware in most cases where his customers are actually receiving the service in question – so he will therefore need two pieces of non-contradictory evidence to confirm the country where the customer belongs. The credit or debit card billing address of the customer will often be one source of evidence, and a second source of evidence might be eg the country where the credit card was issued ie which will usually be the same as the billing address of the customer.
- It is not possible to have a ‘negative’ entry on a MOSS return for a country.

And finally, all suppliers making relevant BTE sales covered by the new rules must keep accounting records for 10 years – a much longer period of time than the four to six year window that we have been used to in the UK for many years.

*Contributed by Neil Warren*

## DIY house building scheme and services

*Summary - The FTT confirmed that the DIY scheme does not apply to services received in the course of construction of a dwelling.*

Mr Johnson is a chartered architect and town planning consultant. He built a house, subcontracting the work to individual contractors.

Mr Johnson submitted a claim under the DIY housebuilders scheme for a refund of VAT. HMRC disallowed part of the claim, including invoices for equipment hire, scaffolding tower hire, digger hire, skip hire and the disposal of excavated materials. HMRC contended that those hire costs related to the supply of services and were therefore not covered by the DIY scheme for new builds.

Mr Johnson contended that DIY house building was zero rated to create a level playing field with developers and that, therefore, HMRC's interpretation of the rules was too strict, given that the disputed items were an essential part of house building.

*Decision:*

The FTT agreed that the services of a builder constructing a residential dwelling are zero rated, but noted that the position under the DIY scheme is different as the zero rating only applies to the supply of materials. The FTT explained that VAT is not recoverable for services, because services cannot be identified as relating to the construction of a dwelling in the same way as materials. The distinction must be applied strictly to avoid abuses. However, there are some concessions; for instance, VAT on the delivery costs of materials, provided that it is invoiced with the materials, is recoverable.

**Comments -** The VAT at stake was small and Mr Johnson was appealing as a matter of principle. This provided the FTT with an opportunity to set out the way the DIY scheme is meant to work.

*Alan Johnson v HMRC [2014] UKFTT 956*

## VAT: reduction of consideration

*Summary - The FTT found that a reduction of the consideration entitled the supplier to VAT repayment.*

Barlin was a trademark attorney. Between 2005 and 2010, it carried out work for Autonomy under a general retainer. Barlin issued various invoices on which it accounted for VAT, but Autonomy did not pay the invoices and Barlin did not make any claim to recover VAT.

Barlin issued a claim for payment against Autonomy, which paid £306,000 in full and final settlement of the original claim for £871,000.

Barlin issued Autonomy with a credit note in relation to the VAT corresponding to the foregone consideration. Barlin then claimed repayment of the balance of the VAT but HMRC refused.

*Decision:*

The FTT first pointed out that there was no bad debt as Autonomy owed nothing to Barlin. HMRC's argument that Barlin's claim for bad debt was out of time was therefore ill-founded. The FTT also referred to the Principle VAT Directive art 90, which applies 'in the case of cancellation, refusal or total or partial non-payment or where the price is reduced after the supply takes place' and which has direct effect. The FTT added that the time limits in the UK implementing provision (VAT Regulations, SI 1995/2518, reg 38) had been repealed with effect from 1 April 2009 and had been found to be unlawful in any event (GMAC VTD 17990).

The FTT also noted that article 90 must be considered in context. It applies to non-payment, as well as where the payment is consensually reduced after the supply has taken place, as was the case here.

Finally, the FTT noted that in any case where reg 38(6) applies or s 80(4) applies because the supplier has, like Barlin, deregistered, and the credit note was issued outside the four year time limit, UK legislation makes it impossible for the taxpayer to exercise its directly effective right under art 90. The FTT therefore disregarded the time limits.

**Comments -** The case suggests that the regime for reductions of consideration tends to be more favourable to the taxpayer than the regime which applies to bad debts. In particular, no time limits apply to claims arising out of a reduction in consideration.

*Barlin Associates v HMRC [2014] UKFTT 957*