Tolley®CPD

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Personal Tax

Domicile dispute not finally decided

Summary – The tribunal determined that the issue of an individual's domicile needed to be determined at a proper hearing.

Lord Wrottesley was born in Dublin and educated in the UK. He married a Swiss woman and they live in Switzerland and London.

In 2001, HMRC opened an enquiry into Lord Wrottesley's claim that he had abandoned his UK domicile of choice. They finally rejected his claim and issued determinations for the years 2000/01 to 2007/08 on the basis that he was domiciled in England and Wales during those years.

Lord Wrottesley appealed and applied to the First-tier Tribunal for a preliminary hearing to determine his domicile of origin.

Decision:

The tribunal judge concluded that the taxpayer's domicile of origin could not be "entirely divorced from the substantive issue, his domicile between 2000/01 to 2007/08". A preliminary hearing on the issue would not settle the matter and it would be preferable to have one hearing to determine all the points under appeal.

The taxpayer's application for a preliminary hearing was dismissed.

Comments – Cases relating to the determination of domicile do not occur frequently. In this case the taxpayer wished to determine his domicile of origin which was just part of the issue relevant to the tax at stake. Hence the decision by the Tribunal that it would need to be determined at full and proper hearing rather than being dealt with as a preliminary issue.

The Right Honourable Clifton Hugh Lancelot de Verdon Baron Wrottesley v HMRC TC4084

Reclassification of dividends into salary not a trigger for PAYE or NICs

Summary - The FTT held that the reclassification of dividends into salary after their payment did not trigger liability to pay PAYE or NICs.

Mr and Mrs Jones were both directors and shareholders of a company which carried on business as a recruitment agency.

Following the insolvent liquidation of the company, HMRC had sought to establish wilful failure to deduct tax and NICs and had attempted to recover those amounts from Mr and Mrs Jones under the Income Tax (PAYE) Regulations, SI 2003/2682, reg 72 and the Social Security (Contributions) Regulations, SI 2001/1004, reg 86.

The first issue was whether Mr and Mrs Jones had known of the failure, as they argued that they had received dividends, not emoluments. The second issue was whether the dividends had been lawfully paid (on the basis that the company had had distributable reserves) for company law purposes.

Decision:

The FTT observed that the obligation to deduct PAYE and NICs arises at the time the earnings are paid to an employee. HMRC accepted that the payments had been dividends when originally paid. Furthermore, the FTT found that these interim dividends had been lawful; profits had been available at the time of payment. The fact that the dividends had later on been reclassified as salary — under the mistaken belief that this would solve issues with an overdrawn loan account — did not affect the position.

Comments - The FTT confirmed that a liability to PAYE and NICs can only arise at the time of payment of an emolument. Consequently, the reclassification of an amount into salary after its payment cannot trigger a liability to PAYE or NICs.

Richard and Julie Jones v HMRC [2014] UKFTT 1082

Unexpected impact of RBC changes

The announcement in the Autumn Statement that the non-domiciled charge is rising to £90,000 for those individuals who want to continue to access the remittance basis after they have been resident in the UK for 17 out of the last 20 years did not come as too much of a surprise.

It sounds like a reasonably sensible linking up with the inheritance tax deemed domicile rules. Unfortunately it isn't, when you think about it. It is also bound to cause confusion because the inheritance tax rules deem the individual to be UK domiciled whereas the non-domiciled charge effectively confirms the non-domiciled status of the individual.

You should note that this proposal creates a major anomaly.

Take an example and let's assume that a non-domiciled individual who has been resident in the UK for a long time, leaves the UK and becomes non-resident for 3 consecutive years and then resumes UK residence. The individual may of course be moving as part of their employment and therefore not planning per se.

On his/her return, the individual will not be liable to the £30,000 non-domiciled charge because he/she will not have been UK resident for 7 out of the last 9 years; similarly the individual will not be liable for the £50,000 (soon to be £60,000) charge because he/she will not have been resident in the UK for 12 out of the last 14 years.

However, the person will be liable to the £90,000 charge on the 17 out of 20 year rule. Something is fundamentally wrong when someone who has not been resident long enough to pay the entry level £30,000 charge and yet get caught for the £90,000 charge.

To be consistent with the non-domiciled charge the test would be residence for 17 out of the last 19 years and that would give an integrity to the regime. However it would be out of kilter with the inheritance tax rule, but that does not really matter. Inheritance tax is an entirely different tax with entirely different consequences and that differential gives rise to no anomaly or trap for the taxpayer. This point may, of course, be picked up and amended before it becomes law.

Contributed by Tony Jenkins

Pension flexibility 2015 (Lecture P871 – 25.54 minutes)

Budget 2014

In his Budget on 19 March 2014, the Chancellor announced what HMRC have called 'the most fundamental change to how people can access their pension savings in nearly a century'. With effect from 6 April 2015, individuals with money purchase savings will be able, from age 55, to have access to their entire pension fund with complete flexibility, if they wish. HMRC go on to say:
'This will allow individuals to make their own choices about how to use their pension savings.'

In order to cater for this new regime, a number of changes have to be made to the existing pensions tax legislation in FA 2004. These are set out in the Taxation of Pensions Bill 2014 which was introduced on 14 October 2014 and which is currently making its way through the usual Parliamentary stages.

The purpose of this short note is to identify some of the key measures which are due to take effect next year. In particular, we examine the amendments which will:

(i) increase the flexibility of the income drawdown rules by removing both the maximum cap on withdrawal and the minimum income requirements for all new drawdown funds from 6 April 2015 onwards;
(ii) enable individuals with capped drawdown to convert to a new flexible drawdown fund once this has been arranged with their scheme providers;
(iii) allow pension schemes to make payments directly from pension savings with 25% taken tax-free (instead of the present tax-free lump sum arrangements); and
(iv) ensure that individuals do not exploit the new system to gain unintended tax advantages where they have already flexibly accessed their savings.

Drawdown pensions

At present, someone who is on the verge of retirement has three main choices: he can purchase an annuity, he can opt to drawdown a permitted amount from his pension pot in line with annuity rates or, if he has sufficient pension income elsewhere, he can go for what is known as flexible drawdown.
Under the first of the drawdown provisions, the maximum permissible drawdown pension is capped at 150% of the 'equivalent annuity', being an amount reflecting the level of a single-life annuity which someone of the same age could acquire with the whole of the drawdown pension fund. This capped drawdown limit is set out in S165 FA 2004.

However, where a drawdown pensioner meets the flexible drawdown conditions, there is no limit on the amount which he can take out each year as his drawdown pension. One of the necessary conditions for flexible drawdown is that he is receiving a secure pension income of £12,000 or more per annum from other sources (see Para 14A Sch 28 FA 2004) – this may include, for example, a state retirement pension or a company pension. Members who have taken advantage of flexible drawdown arrangements can continue to make contributions to a registered pension scheme, but, in order to prevent them recycling withdrawals to obtain further income tax relief, S227A FA 2004 effectively reduces the annual allowance for such members to nil.

The Taxation of Pensions Bill 2014 introduces a distinction between drawdown funds created before 6 April 2015, to which the existing rules in Sch 28 FA 2004 may continue to apply, and drawdown funds created on or after 6 April 2015 which will be known as 'flexi-access drawdown funds'. There will be no restriction on the amount of withdrawals which can be made from this new arrangement.

The current Sch 28 FA 2004 regime will apply to money added on or after 6 April 2015 to drawdown funds which were set up before that date, but only where they are used for *capped* drawdown. Alternatively, a member with this form of drawdown may convert it into the new 'flexi-access drawdown fund' in order to be able to make unrestricted withdrawals from his pension pot. All funds used for pre-6 April 2015 *flexible* drawdown will automatically become 'flexi-access drawdown funds'.

Uncrystallised funds pension lump sum

Authorised payments of lump sums to members from their pension scheme are provided for in S166 FA 2004.

What is known as a trivial commutation lump sum can be paid when a member reaches the age of 60 and the total value of his pension rights under all registered pension schemes is no more than the relevant commutation limit. This is currently £30,000 (Para 7 Sch 29 FA 2004).

The Registered Pension Schemes (Authorised Payments) Regulations 2009 (SI 2009/1171) allow for up to three small personal pension funds of £10,000 or less to be paid out as lump sums. It is understood that some pension providers have been allowing individuals to transfer £30,000 from their existing pension arrangements into three new funds holding £10,000 each so as to take advantage of this rule.

A tax-free lump sum, which is officially known as a pension commencement lump sum, can be paid in connection with a member becoming entitled to his pension. This typically represents 25% of the value of his pension savings.

In order to enable individuals to access flexibly any money purchase pension savings which have not yet come into payment without first creating a 'flexi-access drawdown fund', an uncrystallised funds pension lump sum is to be payable under the new legislation. 75% of each payment will be taxable as pension income at the individual's marginal rate of tax and the remaining 25% will be tax-free, ie. the equivalent of a pension commencement lump sum for each payment. The member must, however, have some lifetime allowance available.

The restricted annual allowance

A restricted £10,000 annual allowance for money purchase pension funds will apply to individuals who have already accessed their pension savings through an uncrystallised funds pension lump sum or a 'flexi-access drawdown fund'. Any unused annual allowance brought forward from earlier tax years will *not* be available to increase this form of annual allowance. The rationale for this provision in the Taxation of Pensions Bill 2014 is explained by HMRC as follows:
'Currently, a £40,000 annual allowance is available in respect of all a member's (money purchase and defined benefit) pension savings. Where pension savings are accessed flexibly, there is an increased risk of avoidance involving the "recycling" of, or diversion of earnings into, the pension commencement lump sum. The (revised) annual allowance will reduce the scope for such avoidance and is proportionate in that it goes no further than is necessary for the policy objective of tackling avoidance behaviour.'

Changes to death benefits

In conjunction with the new flexibility in pension withdrawals the following changes will also come into effect on 6th April 2015 relating to funds held in a pension scheme for an individual on their death.

Currently if you die before any benefits have been drawn and prior to age 75, funds can be distributed by the scheme administrator usually outside of your estate and with no tax deduction. Once benefits have been drawn, an option to pay a continuing income to a dependant exists, who would pay income tax at their marginal rate, or a lump sum could be paid subject to a death tax charge of 55%.

From April 2015 benefits payable from funds following your death will be entirely free of any tax if death occurs prior to age 75, irrespective of the individual to whom it is paid or whether it is paid as a lump sum or flexi-access income.

If death occurs post age 75, remaining funds can still be distributed to nominated beneficiaries in lump sum or income form, but will still be subject to a tax charge depending on how payment is made.

Note - The combination of changes to pensions in payment and on death means pensions can now be used far more flexibly in pension succession and potentially Inheritance Tax planning.

Elements contributed by Robert Jamieson

Transferable allowance for married couples and civil partners (Lecture P872 – 9.35 minutes)

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

Practical steps

The legislation requires that a claimant to a reduced allowance must be married or a civil partner to someone who has elected for a reduced allowance, so that is the order in which the elections must be made.

STEP 1 - Election to reduce personal allowance

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

Practical scenarios

Clearly, the practical situation is generally that the election will be made by someone who has insufficient income to use all of their personal allowance. It would therefore be anticipated that the individual might have very low income indeed (obviously < £10,500). A client who has incurred trading losses would be an obvious choice, including clients with substantial capital allowance claims which eliminate their income.

Client who have claimed relief under the Business Premises Renovation allowance would also potentially be affected as this provides for sideways relief of losses which are not capped by any anti avoidance rules, nor by the cap in Finance Act 2013.

The final type of client who might be affected is a director of a Limited company who draws a salary equal to the NIC threshold, and dividends within the basic rate band. In such a case, although the total income might be £30,000 for example, part of the personal allowance is unused as the dividend tax credit cannot be repaid.

Timing of election

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

In practical terms, it would be preferable for the agent to make the election when the income of both spouses (civil partners) is known, and for a single year. This logically suggests that the election be made on the tax return for the year concerned, as by then the relevant facts will be known. However, the adviser will need to check on the income of the spouse to ensure that the tax reduction would be useful to them, and is available (i.e. the spouse is not a higher rate taxpayer). First elections will therefore be made from April 2016 through to 31 January 2017 if made on the tax return.

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

Non residents

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

Withdrawing an election

Normally when notice is given of withdrawal of an election, this takes effect from the next tax year unless the marriage or civil partnership has come to an end through divorce (decree absolute), order of judicial separation, decree of nullity or in the case of a civil partnership, a dissolution order or order of nullity or order of separation. However, if the election is made on the tax return for the year concerned, it will not be necessary to withdraw the election as it takes effect only for the year made.

STEP 2 : Entitlement to and claiming a tax reduction

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

The individual is married to or in a civil partnership with a person who has made an election under s55C which is in force for the tax year (the spouse or civil partner)

The individual is not liable to tax at any rate other than the basic rate, the dividend ordinary rate or the starting rate for savings for that tax year

The individual meets the residence requirements of s56 (right to claim a personal allowance – includes non-resident EU nationals at present), and

Neither the individual, nor their spouse or civil partner makes a claim to married couples allowance for the year.

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

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

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

Getting the benefit of the tax reduction

Where you have made an election on behalf of your client to reduce the personal allowance, the spouse will have to claim the tax reduction. Given that it is likely that the spouse is employed in many cases, it is unlikely that there will be an agent acting to claim the benefit of the reduction.

You may therefore wish to provide an aide memoir to your client to enable the spouse to claim the relevant tax credit. Providing brief details of how this is done and how to check that any refund is correct could be provided on a standard letter together with HMRC contact centre numbers to ensure that the benefit of the election is passed on without incurring unbillable costs.

The reverse scenario

Although you may only act for one spouse, it is reasonable for your client to expect that you will also advise in the situation where the spouse has little or no income and your client is the basic rate taxpayer who can benefit from a tax reduction.

It would similarly be sensible to assume that the claim for the tax reduction is made on the tax return when submitted, so you will need to ensure that the spouse has made the necessary election for the reduced allowance, either during the relevant tax year or after.

You may therefore like to provide a similar aide memoir setting out the steps for making an election for a reduced allowance (which will be available online via gov.uk) and ask your client to confirm that the election has been made before the tax return is submitted.

Contributed by Rebecca Benneyworth

Employment Intermediaries (Lecture B872 – 9.42 minutes)

HMRC issued for consultation a document entitled Employment Intermediaries – Temporary workers – relief for travel and subsistence expenses. This was published on 16 December 2014 with a closing date for comments of 10 February 2015.

What is an overarching contract of employment?

OACs are a legitimate form of employment contract used by some employment businesses and umbrella companies to place temporary workers on multiple separate work placements, but on terms and conditions of a single permanent employment. The employment business or umbrella company becomes the employer of the temporary worker. However, their premises are not the employees' normal place of work, and they are not the organisation which directs the employee in their day to day tasks. This contractual arrangement enables individuals to access tax relief on travel costs and daily subsistence costs.

For both direct contracts of employment and assignment based temporary worker *contracts, tax relief isn't generally available for travel between home and work.* The terms and conditions of an OAC generate *the* difference in treatment with individuals on more common employment business contracts

Travel & subsistence expenses

Generally tax and NICs relief is not available for the travel and subsistence expenses incurred by employees on travel between their home and their normal place of work as noted above. However an employee can get tax and NICs relief if the place they are travelling to is a "temporary workplace".

Broadly speaking, a temporary workplace is somewhere that the employee must go to in order to perform a task of limited duration, provided that they do not expect to be at the workplace for more than 24 months.

By creating a single employment relationship spanning all of the engagements, OACs stop these rules applying, meaning that each workplace is treated as a temporary workplace provided that the individual expects to be there for less than 24 months.

Umbrella structures have been created to try to circumvent this:

- The individual is employed by the umbrella company under an 'overarching employment contract'
- The employee finds work with the end-clients but the work is done through the umbrella company
- The claim is made that the permanent workplace is an office of umbrella company
- So travel to the end-clients (even for fixed duration work of less than 24 months) is to a temporary workplace
- Both travel and subsistence are claimed as deductible expenses

Some umbrella companies apply salary sacrifice arrangements to the employee's salary before reimbursing travel and subsistence tax-free

- This reduces the umbrella's secondary Class 1 NIC liability
- This will become ineffective from April 2016 if Autumn Statement proposals taken forward

Drawbacks to umbrella arrangements

- Umbrella charges monthly fee to employees for the arrangements
- Often the fee can be more than the tax savings on the travel and subsistence, particularly if salary sacrifice involved
- Complexity of payslips can make it difficult for employees to understand what they have actually earned
- Some schemes try to reduce employee pay below NMW
  - Either by purporting that individual only treated as an employee for IT/NIC purposes, not for employment rights purposes
  - Or setting up the individual as a director of a company – where NMW can be avoided if no service contract exists
  - Both could be challenged on employment law grounds

Potential ways forward

The government cannot condone the use of arrangements in the temporary labour market that are designed to secure a tax advantage that would not otherwise be available to the individual or business concerned. However, the government also wants to ensure that any action it takes does not undermine genuine arrangements. It is therefore exploring possible changes to the tax rules in this area. In weighing up the merits of any proposal, the government wants to ensure that:

- The long established principle that the costs of ordinary commuting are not subject to tax relief is maintained
- The change does not undermine the effective operation of the temporary labour market or of intermediaries that do not misuse travel and subsistence relief
- That any changes will not result in intermediaries shifting into new contrived structures to achieve a tax and NICs saving.

Current actions

Tax

As part of its risk based compliance activity HMRC is undertaking enquiries into umbrella companies and employment businesses using OACs. For example, HMRC recently won a significant case in the Upper Tribunal on a variety of issues surrounding temporary workers and temporary workplaces. As announced at Autumn Statement 2014, from 2016-17 the government is introducing a new tax exemption for certain expenses incurred by an employee and reimbursed by an employer. This was recommended by the Office for Tax Simplification in their review of expenses and benefits. As a result, employers will no longer have to complete P11Ds or apply to HMRC for the use of a dispensation.

However, this new tax exemption will not apply if the payments are made through salary sacrifice schemes. This will stop umbrella companies and employment businesses who currently use OACs (as well as other employers) reimbursing travel and subsistence expenses through salary sacrificeschemes. Employers use these arrangements to artificially reduce both their own and their employees' NICs liabilities.

National minimum wage enforcement

When considering entitlement to the national minimum wage, NMW officers consider the relationship between the parties. NMW wage entitlement arises if the person is a worker or deemed to be a worker under the special rules for agency workers.

NMW reviews of umbrella companies have revealed instances of workers' pay including elements of reimbursed expenses, which should not be taken into account in calculating pay for NMW purposes. Additionally, deductions from the workers' pay for an employer's own use and benefit, cannot bring a worker's pay below the NMW. The deductions identified include (but are not limited to) administration charges or fees for handling specific transactions on entry to a travel scheme, payment of transport costs, a charge for a uniform or the provision of third party insurance.

These items will not count in calculating pay for NMW if they are for the employer's own use and benefit or considered to be an expense in connection with the worker's employment.

Employment status

In addition to this, the review of employment status being undertaken by the Department for Business, Innovation and Skills will look at how greater clarity can be delivered to both employers and individuals, ensuring that both parties can, and do, understand the implications of the contractual arrangement they enter into. For employers, this will ensure they are aware of their responsibilities in terms of NMW, holiday pay entitlement and other basic rights. For individuals, they will be better placed to know their rights and have the confidence to be able to sound the alarm where things go wrong.

Possible options for addressing this avoidance

Tax relief for travel expenses

Potential option 1

One option to address this unfairness, and to reduce the cost of these arrangements to the general taxpayer, would be to introduce legislation to amend the tax rules on travel and subsistence expenses. This legislation would mean that individuals engaged under an OAC by an employment intermediary to work for a third party, cannot claim tax relief for travel, and associated subsistence, from their home to the workplace of the end client.

One way to achieve this would be to determine that where the individual is supplied through a third party the workplace of the end client would in all cases be a "permanent workplace". In this case no relief for travel from home to workplace, and associated subsistence, would be available.

Any change would seek to maintain the travel and subsistence expenses which can be claimed by individuals genuinely seconded to work temporarily away from their regular workplace by their permanent employer.

The government is particularly interested in the potential impacts on Personal Service Companies (PSCs) of any changes to the rules on relief for travel and subsistence expenses available to people working through an employment intermediary. If PSCs were excluded from any changes, there is a risk that employment agencies may be incentivised to encourage individuals to work though their own limited company in order to continue to get tax relief on their home to work travel.

Potential option 2

An alternative option would be to restrict the availability of tax relief for travel from home to workplace, and associated subsistence costs, where the individual was employed by an intermediary specifically under an OAC.

This could be accomplished by stopping OACs being treated for tax purposes as giving rise to a series of temporary "employments" under a permanent contract. is consistent with principle that the costs of ordinary commuting are not subject to tax relief. As this option would specifically or solely affect people employed under OACs, it would not have any impact on PSCs (unless they use an OAC).

Capital Taxes

Entrepreneurs' relief – director or employee? (P873 – 14.07 minutes)

One of the conditions for the application of entrepreneurs' relief is that the individual must have been an officer or employee of the company throughout a period of at least one year ended with the date of the disposal (S169I(6) TCGA 1992). This requirement was recently given an exhaustive examination by the First-Tier Tribunal in Hirst v HMRC (2014).

Mr Hirst had been a director of the company for nearly three years, but he ceased to be so in December 2007. He sold his shares, which represented about 13.5% of the company's share capital, in July 2009 and claimed entrepreneurs' relief in respect of his gain. HMRC denied the claim on the basis that Mr Hirst did not satisfy the condition in S169I(6) TCGA 1992.

However, despite his resignation as a director, Mr Hirst was still involved in sourcing new business for the company. He retained a laptop and a mobile phone provided by them and the company continued to pay for internet access at his home. He received board packs, liaised with the company's CEO and contributed to the ongoing business strategy of the company.

Clearly, if Mr Hirst was going to obtain entrepreneurs' relief, he needed to demonstrate that he was either:

- a de facto director;
- a shadow director; or
- an employee.

The Tribunal decided that he was not a de facto director within S250 Companies Act 2006, being 'a person occupying the position of director, by whatever name called'. The judge felt that Mr Hirst's influence in the corporate governance of the company was commensurate with, but limited to, that of a significant shareholder.

Had Mr Hirst been a shadow director within the meaning of S251 Companies Act 2006? This section refers to 'a person in accordance with whose directions or instructions the directors of the company are accustomed to act'. Here, too, the Tribunal found against Mr Hirst – he did not direct or instruct the board on how to act. He was not therefore a shadow director.

But that was not the end of the matter. The Tribunal also considered whether Mr Hirst had been an employee. Initially, this seemed to be a somewhat unlikely proposition because he did not appear to do very much for the company nor was he paid.

However, Mr Hirst had agreed with the company that he would be entitled to commission for the introduction of any new business (although, in the end, no such commissions were ever paid) and the company continued to provide him with what might be called non-cash remuneration in the form of a laptop, a mobile phone and home internet access. He was also under the control of the company and so the Tribunal concluded that these facts were not inconsistent with an employment relationship.

Mr Hirst was therefore allowed to claim entrepreneurs' relief.

This decision is a reminder of the importance of ensuring that an employment relationship has to continue if a shareholder is to claim entrepreneurs' relief on a sale of shares. In this case, although there was no formal employment relationship, Mr Hirst was fortunate that the First-Tier Tribunal was prepared, on the particular facts, to treat him as an employee. However, it will always be safer to rely on a formal employment relationship. There was no indication of the size of Mr Hirst's gain, but, if it was substantial, it would be surprising if HMRC do not take the case to appeal.

Contributed by Robert Jamieson

CGT share pooling – dipping our toes in (Lecture P874 – 17.17 minutes)

Introduction

People encountering for the first time the CGT rules for quoted shares often find them puzzling. So why do we need special rules for quoted shares?

Like other chargeable securities (e.g. units in a unit trust), quoted shares are different from most CGT chargeable assets in one key respect. If you sell, for example, a painting or real estate, as long as you have your paperwork (or, these days, electronic documentation in many cases), you will know exactly when you bought it and how much you paid for it. A gain or loss on disposal can therefore be calculated.

In contrast, if I sell 1,000 shares in a quoted company, out of a total holding of 8,000 that has been acquired in several different tranches for various costs, which shares am I getting rid of? As they are fungible (i.e. as indistinct as frozen peas), the answer is of course that it could be any of them; but this is no good for CGT, as I need to have specific costs to match against my sale proceeds. There are therefore special 'matching rules' for determining which shares are being sold at any given time.

This article will remind readers how the current matching rules for individuals (which have been in place since 6 April 2008) work and also point out a few traps that can catch the unwary. All references, unless otherwise stated, are to the TCGA Act 1992. I will only deal with UK listed companies that have shares quoted in sterling and all investors in the examples are UK resident and domiciled.

Note that where quoted shares are owned by companies, the matching rules are significantly different and are beyond the scope of this article.

History

Since the introduction of CGT in 1965, there have been several reforms of either the tax generally, or the matching rules in particular, which have affected the calculation of gains and losses on quoted shares. Just considering those from the mid-1980s onwards, we have had:

- The creation of an indexed pool for quoted shares in FA 1985.
- In FA 1988, the rebasing of CGT to only tax gains arising post 31 March 1982, but to tax them at marginal income tax rates
- In FA 1998: the freezing of indexation allowance (relief for general inflation on cost) at its April 1998 value and the introduction of taper relief. This Act also made major changes to the matching rules, in particular
    - introducing individual matching, rather than pooling, for post 5 April 1998 acquisitions; and
    - effectively ending 'bed and breakfasting' (i.e. selling quoted shares just before the end of the tax year to crystallise a gain that uses up CGT annual exemption, then buying them back the next day) by introducing a 30 day 'matching forwards' rule (see later).

FA 2008 brought the abolition of indexation allowance and taper relief, the introduction of a flat rate of CGT of 18% (unless entrepreneurs' relief is available) and a return to full pooling of quoted shares, rather than individual matching.

Finally, in the June 2010 Budget, there was the introduction of a 28% tax rate for gains above the basic rate band. What we have been left with is a relatively simple system for dealing with quoted shares, certainly much less complicated than most of its predecessors. The reason for mentioning these old rules, however, is that they can impact on your calculations for a disposal under the current rules, something we will look at shortly

Current matching rules

The current matching rules in s.106A provide that, for matching acquisitions and disposals of shares of the same class in the same company held in the same capacity, disposals must be matched in the following order:

1. Against acquisitions on the same day (s.105(1)(b)).
2. Against acquisitions within the 30 days following the disposal, provided the person making the disposal was resident in the UK at the time of the acquisition (s.106A (5) and (5A)).
3. Against shares in a s.104 holding (i.e. pooled shares) (s.104).
4. Finally against acquisitions following the disposal (and not already identified under stage 2 above), taking the earliest acquisition first (s.105 (2)); this item is rarely encountered in practice.

Note that s.99 treats units in a unit trust as though they are shares in a company.

The following examples will show how these rules are applied. In each case, sale proceeds are net of all dealing costs, such as brokers' fees, and purchase prices include incidental costs, such as brokers' fees and stamp duty reserve tax (SDRT).

Example: Sadie

- *Bought 1,000 shares in Mane plc in June 1992*
- *Sold 450 on 26 February 2014 at 9am*
- *Bought back 300 at 2pm the same day*
- For tax purposes, the shares deemed sold are
  - 300 bought on 26.2.14 (same day acquisition)
  - 150 of those bought in June 1992 (s.104 holding)
- Shares still owned by Sadie are deemed to be 850 of those bought in 1992

Example: Ryan

- *Bought 600 shares in Bertie plc in August 1991*
- *Bought another 400 shares in September 2004*
- *Sold 500 on 27 March 2014*
- *Bought a further 300 on 14 April 2014*
- For tax purposes, the shares deemed sold are:
  - 300 bought on 14 April 2014 (acquired in the 30 days following disposal)
  - 200 of the other shares (which are pooled together in the s.104 holding), taken at weighted average cost
- Ryan still owns 800 shares, which are the remaining pooled shares

Example: Matt

Matt had the following transactions in the shares of Targett plc:

1 September 1979	*Bought 3,000 shares for £9,000*
1 May 2004	*Bought 1,500 shares for £7,500*
8 April 2014	*Sold 4,000 shares for £34,000*
15 April 2014	*Bought 500 shares for £2,800*

The shares were worth £3.50 each on 31.3.82.

What is Matt's capital gain?

He sells 4,000 shares, which are matched as follows:

- 1st	-	15 Apr 2014	-	500 shares (acquisition in following 30 days)
- 2nd	-	Pool	-	3,500 shares (out of 4,500)

The gain calculations are therefore:

1) Match with 15 April 2014 acquisition

	£
Proceeds £34,000 × 500/4,000	4,250
Cost	(2,800)
Gain	1,450

2) Match with pool

	£
Proceeds £34,000 × 3,500/4,000	29,750
Less: cost (W)	(14,000)
Gain	15,750

Total gain on disposal is therefore 1,450 + 15,750 **£17,200**

Working

s.104 Pool	**Shares**	**Cost**
pre-31.3.82 shares @ £3.50	3,000	10,500*
1.5.04	1,500	7,500
Total	4,500	18,000
Less:	(3,500)	(14,000)**
c/fwd pool	1,000	4,000

*Due to the rebasing rules, these shares are included in the pool at their 31.3.82 MV

** This is £18,000 x 3,500/4,500

A little knowledge is a dangerous thing...

Unfortunately, long superseded rules can sometimes impact on current disposals.

Example: Toby

Toby, a client who has never previously filed a CGT return with you, asks about his potential capital gains exposure. He is a basic rate taxpayer who, this year, has £6,000 of unused basic rate band.

As best as you can tell from the paperwork he has given you, his transactions in the shares of Belgium plc have been as follows:

January 1996 Bought 6,000 for £3,000 (50p each)

August 2000 Bought 4,000 for £28,000 (£7 each)

November 2002 Sold 3,000 for £27,000 (£9 each)

He is looking to sell the remaining 7,000 shares, which are trading at about £5.50 each.

This is where some knowledge of history comes in useful. The weighted average cost of the previous acquisitions is £3.10 ((£3,000 + £28,000) / 10,000). A comparison with the likely sale price of £5.50 gives a gain of £2.40 per share on 7,000 shares, i.e. £16,800, leaving a gain after annual exemption (£11,000 in 2014/15) of £5,800 and tax @ 18% of £1,044. However, this would be incorrect advice to the client, as it ignores the fact that the current matching rules were only introduced in FA 2008!

The sale in November 2002 would have been under the previous (taper relief) regime, when acquisitions after 5 April 1998 were not pooled, but instead matched individually on a LIFO basis (before matching with the pool of pre 6 April 1998 acquisitions). The first sale would therefore have been matched against 3,000 of the shares acquired in August 2000.

Thus the pool at the current date consists of 6,000 shares (cost £3,000) plus 1,000 shares (cost £7,000), giving 7,000 shares with a CGT cost of £10,000. If these are now sold for £5.50 each, the gain arising will be £28,500, or £17,500 after annual exemption. Given his income tax position, the CGT on this will be (£6,000 @ 18%) + (£11,500 @ 28%) = £**4,300**.

Conclusion

When dealing with CGT disposals, it is important to consider the full history of dealings that the client has undertaken. Disposals pre-6 April 2008 were under earlier matching regimes, so be very careful about the CGT cost of shares still held.

Contributed by Kevin Read

IHT: severance of joint tenancy

Summary - The FTT found that a joint tenancy had been severed so that a property passed under a will using the IHT nil rate band.

Mr and Mrs Tobin had been married for many years when Mr Tobin passed away. They had held the matrimonial home as joint tenants; therefore, for it to pass under Mr Tobin's will (and not by survivorship), the joint tenancy should have been severed. The appellants believed that such severance had taken place, but the document to that effect could not be located.

Under the will, a 'Nil Rate Band Trust' came into effect. The amount to be given to the trust was to be equal to the upper limit of the nil rate band. If part of his share in the house had passed under the will, Mr Tobin's nil rate band would have been used to the full extent (£255,000). If the house had passed to Mrs Tobin by survivorship, the benefit of the Nil Rate Band Trust would have been lost.

Decision:
The FTT noted that the burden of establishing the severance of the joint tenancy fell on the appellants. Under LPA 1925 s 36, in order to severe the joint tenancy, one tenant should have given written notice to the other. As no written record of such a notice existed, the question of whether notice had been given must be examined on a balance of probabilities and reviewed in the context of the evidence as a whole. The evidence, in particular, included the existence of a draft notice of severance and of emails referring to the notice, as well as the preparation of the IHT accounts on the basis that the joint tenancy had been severed. This all pointed towards severance.

Comments - The FTT was prepared to place a lower burden on the appellants, stating: 'if something inherently improbable requires strong evidence, it follows that something less improbable requires less evidence'. This may be relevant in many situations beyond the scope of IHT.

Parveen Chadda and others v HMRC [2014] UKFTT 1061

Reversionary leases and settled property (Lecture P875 – 18.53 minutes)

The development of reversionary lease arrangements was closely associated with the IHT planning schemes which gave rise to Ingram v CIR (1999). This case was won by the taxpayer in the House of Lords, but the then Chancellor promptly tightened up the reservation of benefit rules in FA 1999 and this was followed some years later by the pre-owned asset income tax legislation.

Note that reversionary leases (like Ingram schemes) involve what is usually referred to as a shearing operation. Also, where residential property is in point, there are often CGT problems in the event of a sale of the property – hence these arrangements are best suited to cases where it is envisaged that the property will be retained within the family and never sold.

One difference is that, with Ingram, it was necessary first to carve out a lease and then to gift the encumbered freehold reversion, whereas reversionary lease arrangements represent a single-stage transaction merely requiring the grant of a lease.

Nowadays reversionary lease arrangements commonly use commercial or industrial property. Consider the illustration in (e) below.

Illustration

William has owned the freehold of a let commercial property for many years. It is currently worth £1,000,000. William, who is aged 72, would like to keep the rent for, say, the next 15 years but give away the capital value.

He therefore grants a reversionary lease (vesting after 15 years) to a settlement for his adult children. He retains the rent (given that he is the freeholder) and the property's value on the transfer to the trust will be heavily depleted because of the deferral. The value settled, in these circumstances, is unlikely to be more than £325,000.

Because William has used a trust, CGT holdover relief under S260 TCGA 1992 will be available. And, by virtue of S102A(5) FA 1986, there should be no reservation of benefit given that William has owned the property for more than seven years.

HMRC have confirmed that reversionary lease arrangements are still effective provided that the seven-year defence mentioned in (e) above is available (see Para IHTM44102 of the Inheritance Tax Manual).

What about the pre-owned asset regime? The position here is that, if the property which is subject to the reversionary lease is occupied by the disponor, there will be a pre-owned asset charge. However, where the property is rented out (as is the case with William above), there is no charge – it is William's tenant, and not William, who is occupying the property.

Contributed by Robert Jamieson

Administration

No jurisdiction with a contract settlement

Summary – The Tribunal held that the contract settlement took precedence over the standard appeals procedure.

The owner of a farm died in January 2005. Two of his four sisters were appointed executors. The farm was valued at the date of his death at £650,000 but, because it qualified for agricultural property relief, the estate was below the inheritance tax threshold. The farm was sold in 2006 for £800,000. The executors claimed capital losses on the sale, claiming that the sale proceeds of the farm should be substituted for the probate value.

HMRC refused the claim and the matter was referred to the district valuer. He valued the farm at £740,000 at the date of death and stated that the amount was accepted by the executors and beneficiaries. In May 2010, on the basis of this valuation, HMRC negotiated a settlement for tax, interest and penalties; the sum was agreed and paid.

In September, the appellants complained to HMRC that the farm had not been properly valued. The complaint was not upheld, so the appellants appealed to the First-tier Tribunal.

HMRC said the First-tier Tribunal had no jurisdiction in this matter because the issue had been resolved by contract settlement.

Decision:

The First-tier Tribunal agreed with HMRC. The judge said it was "implicit that a contract settlement takes effect outside the statutory regime of assessments and appeals". In this instance, the tax had been paid and the only option for the appellants appeared to be to start proceedings against HMRC for recovery of sums paid under a mistake.

The taxpayer's appeal was struck out.

Comments – Taxpayers need to be careful that they fully understand the terms of any contract settlement as the judge described it succinctly when he said… it was "implicit that a contract settlement takes effect outside the statutory regime of assessments and appeals".

D M Morris; J Gregson v HMRC TC4098

Evidence of dishonest conduct

Summary - The FTT found that HMRC had not provided sufficient evidence of dishonest conduct.

Brendan Kelly purchased doors and windows from Bal4 Windows, a UK company based in Northern Ireland and VAT registered in the UK. HMRC contended that the supplies were zero rated, as Kelly used a VAT number from the Republic of Ireland belonging to a John Cullen. Kelly denied HMRC's contentions.

Decision:

HMRC's evidence was mainly hearsay and, although such evidence was acceptable, the FTT noted that it carried little weight. This was even more so, given that the individual who had provided the relevant information to HMRC did not appear as a witness and his reliability could therefore not be tested. The FTT also noted that the appellant had fabricated evidence. There were clearly unresolved questions about the facts. The FTT concluded that the items of HMRC's evidence were not sufficiently reliable to form the basis of an assessment.

Comments - The taxpayer had clearly misrepresented the truth on several occasions, yet his appeal was allowed, as HMRC's evidence was not satisfactory.

Brendan Kelly v HMRC [2014] UKFTT 1012

Further hearing required

Summary – The Tribunal dismissed the taxpayers' appeal

The company submitted its 2002 and 2003 corporation tax returns claiming relief for amortisation of goodwill in each. In the 2004 and 2005 returns, the company claimed terminal loss relief arising out of the goodwill.

HMRC opened enquiries into the returns. They refused the claims in each return and issued closure notices. The company appealed against the amendments in the 2002 and 2003 returns on the grounds that it was entitled to the relief and it had paid the tax claimed.

The First-tier Tribunal dismissed the appeal. The company appealed and also appealed against the 2004 and 2005 closure notices.

The taxpayer argued that a claim for terminal loss relief was not included in the 2004 and 2005 returns but was made in a letter sent with the returns. Therefore HMRC should have opened an enquiry under TMA 1970, Sch 1A, and not FA 1988, Sch 18 para 24. As a result, the closure notices were not valid.

Decision:

The Upper Tribunal disagreed, saying that the letter sent by the taxpayer and its accompanying documents could be seen as part of the return.

The closure notices were, therefore, effective in rejecting the claims and amending the returns. On that basis, the appropriate forum for determining the validity of the 2004 and 2005 closure notices was the tax tribunal. But, because those documents had no relevance to the appeal against the 2002 and 2003 closure notices, they had to be subject to a separate appeal (which had already been lodged).

The Upper Tribunal dismissed the taxpayer's appeal.

Comments – This is another episode in the continuing saga of the war of attrition that the taxpayers are waging with HMRC. The result was not surprising based upon the facts.

Spring Salmon & Seafood Ltd v CRC, Upper Tribunal

Long-term depression is an excuse

Summary – The Tribunal found that the taxpayer's long term depression was a valid reasonable excuse.

The taxpayer appealed against surcharges made for the late payment of tax, claiming he had reasonable excuse. HMRC confirmed the surcharges, so the matter proceeded to the First-tier Tribunal.

The taxpayer had been diagnosed with long-term serious depression and anxiety. He said that, although it might seem that someone able to earn about £120,000 in a year should be able to submit a tax return and pay his tax on time, this was not the case for someone with these conditions.

He drew attention to a document from the mental healthy charity, Mind, Tax and mental health — removing barriers and to another factsheet, Discrimination and mental health. He claimed that, in confirming the surcharges, HMRC demonstrated that they did not understand the nature of this illness and were therefore, in effect, discriminating against him.

Decision:

The tribunal judge asked why, if he knew of his long-term illness, the taxpayer had not appointed an accountant to look after his affairs or sought help earlier. The taxpayer explained that it was hard for him to admit to anyone that he was ill or even talk to his partner about it. That was part of the illness.

The tribunal said it was clear that the taxpayer's affairs had become in arrears as a result of his illness but he had now appointed an adviser and his affairs were up to date.

The taxpayer's appeal was allowed.

Comments – Reasonable excuse can take a number of forms and is a matter for the decision of the Tribunal. The taxpayer earned a significant amount of money but was well prepared for the Tribunal as the obvious argument had a rational explanation. Additionally the appointment of an advisor and bringing the affairs up to date clearly helped the judge to find in the taxpayer's favour.

G Wedgwood v HMRC TC4148

Notice is appropriate

Summary – The Tribunal Found against the taxpayer and the penalties stood in the amount of £900.

The taxpayer's appeal against daily penalties amounting to £900 in respect of a late filed tax return was allowed by the First-tier Tribunal. This was on the ground that HMRC had not given proper notice to the taxpayer from what date the penalties would be imposed. HMRC appealed.

The Upper Tribunal agreed that one purpose of a notice under FA 2009, Sch 55 para 4 was to warn the taxpayer that he would suffer daily penalties if he did not file his return. However, it could not have been the draftsman's intention that HMRC should have to make individual decisions for every taxpayer who fails to submit the form for more than three months after the due date. Rather, HMRC "decide in advance that all taxpayers who default for more than three months should suffer daily penalties". The self-assessment reminder and the SA326D (late tax return notice of penalty assessment) were "unequivocal statements of HMRC's intention" and satisfied the requirements of para 4(1)(c).

HMRC's appeal was allowed and the penalties of £900 imposed on Mr Donaldson restored.

Comments - Keith Gordon of Atlas Tax Chambers said: "The statutory wording concerning the daily penalties is ridiculously unclear. However, pending the unlikely scenario of another taxpayer wishing to take the matter to the Court of Appeal, the Upper Tribunal's decision at last settles the question about the validity of HMRC's daily penalties under the FA 2009 rules.

"What is particularly strange, however, is that the Upper Tribunal's interpretation (combined with HMRC's current practice) means that taxpayers who file their returns on paper can be more harshly penalised than those who file electronically. In particular, if a daily £10 penalty is supposed to create a sense of urgency, it would make more sense for the taxpayer to be warned of these increasing penalties prospectively so that penalties can be minimised. Paper-filers, however, will be 'warned' only after it is too late and the maximum £900 penalties have already been incurred.

"Tax is generally recognised to be complex. But surely one is entitled to expect the rules for penalties for late returns to have been simpler and more logical?"

He added: "This decision has no impact on the points raised in my recent articles in Taxation, 'Hamstrung durch Technik', 6 February 2014, and 'Technikal progress', 20 November 2014, about the automation of penalties issued under TMA 1970."

CRC v K Donaldson, Upper Tribunal

Barring order dispute

Summary – The Upper Tribunal has lifted the barring order reported in the November 2014 notes

HMRC ruled that the supplies of books and other materials made by the companies in the BPP group should be standard-rated under VATA 1994, Sch 8 group 3 notes (2) and (3). The taxpayers appealed, contending that they should be zero-rated.

The matter proceeded to the First-tier Tribunal. BPP said HMRC had not set out their position satisfactorily in the statement of case and applied for more information. The tribunal agreed and directed that the Revenue should supply the information by 31 January 2014. The judge made an order under Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009, rule 8(3)(a) to the effect that, unless the information was provided within the time, HMRC would be barred from taking further part in the proceedings.

In March 2014, BPP applied to the tribunal to have the order enforced because HMRC had not produced the information required. This tribunal agreed and barred HMRC. In July HMRC applied for a direction to cancel the order, but the First-tier Tribunal declined the request. HMRC appealed.

Decision:

The Upper Tribunal said the barring order should not be implemented. It was true that BPP had been put to expense in obtaining the information required, and there had been “significant, unnecessary and unwarranted delay” by HMRC. Further, there had been little explanation from the department why it had not done what was required, so HMRC attracted “little sympathy”.

However, if the order were imposed, it might “hand an unwarranted windfall to BPP” and there would be no adequate determination of whether the taxpayers' supplies should be zero-rated. Refusing the order would give the First-tier Tribunal the opportunity to decide the appeal fairly and justly “after full argument”.

HMRC's appeal was allowed and the barring order lifted.

Comments - If the barring order were imposed, it might “hand an unwarranted windfall to BPP” and there would be no adequate determination of whether the taxpayers' supplies should be zero-rated. Accordingly the FTT would get an opportunity to assess the correct staus.

CRC v BPP Holdings Ltd, BPP Learning Media Ltd, BPP University College of Professional Studies Ltd, Upper Tribunal

Recovery of tax wrongly refunded by way of discovery assessment

Summary - The FTT found that HMRC had been entitled to issue a discovery assessment to recover tax wrongly refunded to the taxpayer.

HMRC's automatic system had wrongly calculated the tax liability of Mr Jones, due to an error in his self-assessment return which suggested that he had overpaid tax. The 'overpayment' was repaid to Mr Jones, who did not query it.

Having received a PAYE return from Mr Jones' employer, HMRC realised the error and issued a discovery assessment for the correct amount. Mr Jones did not dispute the correctness of the figure and accepted HMRC's calculations. However, he claimed that he should not be expected to refund the monies, together with interest, three years after having received the monies back from HMRC.

Decision:

The FTT found that the discrepancy between the PAYE return delivered by Mr Jones' employer and Mr Jones' self-assessment return was a discovery (TMA 1970 s 29(1)). Furthermore, the error was due to the careless behaviour of Mr Jones, who should have checked the accuracy of his return before submitting it. HMRC had therefore been entitled to raise a discovery assessment within four years from the end of the relevant tax year (TMA 1970 s 29(4)).

Comments - This case was slightly unusual, in that HMRC had refunded tax by mistake. The FTT confirmed that, for PAYE purposes, the receipt of new information via the filing of an employer's return can constitute a discovery. Employees should therefore ensure that their self-assessment return matches their employer's PAYE return.

Patrick Jones v HMRC TC4140

Lack of care over tax affairs is not a reasonable excuse

Summary – The Tribunal had decided that the taxpayers should have ensured the appeal was lodged in time

HMRC made informal requests to the taxpayers for details of their taxable income. They did not respond so, in March 2012, the Revenue issued information notices under FA 2008, Sch 36 para 1. The taxpayers did not comply with these so HMRC imposed penalties on each of them.

In August 2012, the taxpayers' former adviser submitted partnership and individual returns for the six years ended 5 April 2011. HMRC accepted the figures in the returns but the taxpayers did not pay the outstanding tax or offer to settle their liabilities. HMRC imposed penalties under FA 2008, Sch 41 for failure to notify a tax liability.

The taxpayers appealed saying they had reasonable excuse for the failure to notify because HMRC had not issued them self-assessment returns. HMRC did not accept that excuse because the taxpayers had previously been in self-assessment. The taxpayers made a late appeal to the First-tier Tribunal.

Decision:

The tribunal said there was no good reason for the long delay before the taxpayers appealed. At the hearing, the taxpayers cited reliance on a third party as a reasonable excuse, but the judge did not accept that. He said the taxpayers had not acted with "reasonable prudence and diligence in dealing with their tax affairs". They had not co-operated initially and, if they were not happy that their adviser was doing a good job, they should have taken action to confirm the progress of any appeal.

The taxpayers were aware of the time limit for appealing to the First-tier Tribunal. This did not require the services of an adviser and they should have ensured the appeal was lodged in time.

The taxpayers' late appeal was not admitted.

Comments – The result should not be regarded as entirely unexpected. The taxpayers in this case effectively abrogated their responsibilities for a significant length of time. The concept of a reasonable excuse is exactly that and not a get out of jail free card. In this case leaving returns undone for six years and then not paying the tax might be perceived to be "taking the mick".

A Pia and F Pia v HMRC TC4111

40% penalty upheld in the absence of a reasonable excuse

Summary - The FTT found that a 40% penalty was due as a result of the negligence of the taxpayer, in the absence of a reasonable excuse.

Mrs Martin ran a business selling ephemera (including books, maps, postcards, theatre memorabilia and documents) on the internet and via other outlets. HMRC had run an enquiry into Mrs Martin's 2007/08 return over a period of almost five years. Over that time, HMRC had repeatedly reminded the taxpayer that the lack of business records delayed the progress of the enquiry.

One of the key issues was whether she had provided her accountants, who had submitted her tax return, with ebay and PayPal records evidencing internet sales which doubled her profits and were not recorded in the accounts on which the return prepared by her accountants was based. Mrs Martin had also made untrue statements in relation to other issues; and it was considered unlikely that a firm of accountants would have ignored ebay and PayPal records if they had been provided. On the basis of the evidence, the FTT found that Mrs Martin had not provided those records.

Decision:

The FTT observed that the test for negligence is objective. A reasonable person, 'who conducted her business in accordance with her statutory obligations, would have realised that the turnover and profit figures included on her SA return were too low'. Consequently, even if Mrs Martin had provided the records, it would have been negligent not to check her return and to notice that the profit figure was understated.

Finally, the FTT found that Mrs Martin had not established a reasonable excuse. Although the FTT accepted that she had been under considerable stress due to her husband's bankruptcy, the tribunal pointed out that as she had been able to run a business with an annual turnover of £177,000, she must have been able to file an accurate return.

The FTT therefore confirmed the 40% penalty, slightly amending its make up according to disclosure, cooperation and gravity (TMA 1970 s 95).

Comments - The FTT's remarks about the difference between negligence (TMA 1970 s 95) and carelessness (under FA 2007 Sch 24 para 3, which applies from 2008/09) are worth noting. The FTT observed that whilst negligence is an objective concept, carelessness includes an element of subjectivity

Catherine Grainne Martin v HMRC TC4117

Late filing and reasonable excuse

Summary - The FTT found that a taxpayer who had filed his return late because of a delay in receiving an authorisation code from HMRC did not have a reasonable excuse.

Mr Hegedus was appealing against a penalty for late filing of his self-assessment return. His accountant had sent a letter to HMRC explaining that the only reason for the delay was that Mr Hegedus had used an accountant for the first time. He had not realised that this accountant did not run commercial soft ware and so must order an authorisation code from HMRC which was delivered by post.

Decision:

Agreeing with HMRC, the FTT found that Mr Hegedus had not established a reasonable excuse. There had been no unexpected or unforeseeable event which had caused the delay. Furthermore, Mr Hegedus should not have left it so late to file his return, as this was running the risk that a problem would arise.

Comments - Mr Hegedus had assumed that his accountant would be able to obtain an authorisation code immediately. This was the wrong assumption but it did not amount to a reasonable excuse. Furthermore, the FTT stressed that a diligent taxpayer would not have waited until the last minute. A reasonable excuse claim may therefore be weaker in circumstances where the taxpayer has not given himself a margin of error.

Zoltan Hegedus v HMRC TC4142

The NCA and the raising of discovery assessments

Summary - The FTT found that the National Crime Agency (NCA) had been entitled to raise discovery assessments.

On 15 December 2007, the Serious and Organised Crime Agency (SOCA), the predecessor of the NCA, had executed a warrant at Mr Lynch's address, as it suspected Mr Lynch to be in receipt of income through connection with a crime group. The SOCA found over £250,000 cash. It sought and obtained forfeiture of the cash on the ground that it represented the proceeds of crime.

Mr Lynch had been a sole trader running a café and HMRC considered that the income declared in his tax returns fitted what may be expected from such a business. However, a review of his bank accounts suggested that Mr Lynch had a second source of income. This led the NCA to conclude that incorrect returns had been filed for the years 2001/02 to 2008/09 inclusive. The NCA set out the total liability together with interest and Mr Lynch appealed.

Decision:

The first issue was whether the Proceeds of Crime Act 2002 s 317(1)(a) was satisfied: did the NCA have reasonable grounds to suspect that income arising to Mr Lynch was chargeable to income tax and arose directly or indirectly as a result of criminal conduct? On the basis that Mr Lynch had unexplained deposits in his bank account and that cash had been found at his home, the FTT concluded that such a suspicion was established.

The second issue was whether the conditions for a discovery assessment were met (TMA 1970 s 29). The FTT noted that the unexplained deposits constituted a discovery, and that their omission from the returns was, at the very least, careless. Additionally, the relevant HMRC officer would not have been aware of the issue at the end of the enquiry periods for the relevant tax years.

The last issue was the applicable time limit to raise the discovery assessments. The FTT found that the 20 year time limit — which applies in cases of deliberate concealment — was appropriate (TMA 1970 s 36(1A)). It was clear that Mr Lynch had deliberately omitted from his tax returns information relating to his other source of income.

Comments - This case is a useful example of the circumstances in which the NCA can assess to tax individuals suspected of criminal behaviour.

Terence Lynch v NCA [2014] UKFTT 1088

Fighting a lead case direction

Summary - The FTT found that the case of General Healthcare was bound by Nuffield [2013] UKFTT 291.

In relation to the choice of prosthesis by consultants, General Healthcare did not contend that the facts in its case were materially different from that in Nuffield. Rather, it argued that the FTT in Nuffield had failed to consider the correct facts in applying the law, as it had found it to be and submitted that it would be wrong for the FTT to perpetuate such an error by making a lead case direction in a related case.

Decision:
The FTT found, however, that this was a matter of law which must be considered by the UT.

As for the existence of contractual agreements between consultants and the hospital, the FTT found that there was no material difference between the two cases, as contracts were not established in either.

Finally, the FTT found that the fact that insurance covered invoices were issued directly to insurance companies in one case, and first to patients (who then recovered from insurance companies) in the other, was not a material difference.

Comments - This case sets out the considerations which apply when deciding whether a case, which is subject to a lead case direction, should be bound by the lead case. Clearly, only material factual differences will lead to a departure from the lead case direction. As to questions of law, these are for the UT to ascertain on appeal from the decision of the FTT.

General Healthcare Group v HMRC [2014] UKFTT 1087

Application for a closure notice

Summary - The FTT refused an application for a closure notice on the ground that the length of the enquiry was due to the taxpayer's fault.

Mr Khan had submitted his tax return on 24 January 2012 and HMRC had opened an enquiry on 26 July 2012. It had taken the taxpayer until June 2013 to provide HMRC with bank statements relating to previously undisclosed bank accounts. The statements showed large deposits and withdrawals; and HMRC had requested evidence of the source of the deposits and an explanation of the nature of the withdrawals. Mr Khan (via his agent) had only supplied part of the information. On 10 May 2014, Mr Khan had applied to close the enquiry.

Decision:
The FTT refused the application, noting that it had reasonable grounds for doing so. Mr Khan had not provided HMRC with the information requested, without offering any explanation.

The obvious inference was that the information was connected with Mr Khan's business and that the income declared in his tax return was not correct. The delays in HMRC's enquiry had been caused solely by Mr Khan's failure to provide HMRC with the information it required.

Comments - Clearly, the inquiry had been ongoing for too long — two years. However, given that the delay was caused by the taxpayer's lack of cooperation, the FTT would not grant the closure notice.

Bilal Khan v HMRC [2014] UKFTT 1050

Can exemption from air travel tax represent state aid?

Summary - The CJEU found that the exemption from Irish air travel tax may constitute state aid.

In 2009, Ryanair had lodged a complaint, claiming that the nonapplication of Irish 'air travel tax' (ATT) to transit and transfer passengers constituted illegal state aid for the benefit of the airlines Aer Lingus and Aer Arann, as these undertakings had a relatively high proportion of such passengers and flights.

The Commission had found that the measure was not selective and therefore did not constitute state aid in breach of TFEU art 107(1). It fell to the CJEU to review the Commission's decision.

Decision:

The CJEU observed that, in order to classify a domestic tax measure as 'selective', therefore representing state aid, it must identify the common tax regime in the relevant member state. It noted that the Commission had relied on a letter from the Irish authorities, which suggested that the part of a journey exempt from ATT was the first. However, this was not supported by the table produced in the Commission's decision. Furthermore, the Commission's reference to the avoidance of double taxation of passengers on a single journey as the objective of the exemption was not supported by the fact that the tax was borne by airline operators and not passengers.

The CJEU concluded that there were some inconsistencies between the letter from the Irish tax authorities and the Commission's decision, which suggested that the Commission had not carried out a sufficiently complete analysis of the selective nature of ATT. Its decision was therefore in breach of the applicant's rights and must be annulled.

Comments - By annulling the Commission's decision, so that a proper investigation can be carried out, the CJEU recognised that a tax like ATT — which may be indirectly advantageous to certain undertakings — can be deemed selective so as to represent state aid.

Ryanair v European Commission (T-512/11)

Refusal to give a ruling is not a decision

Summary - The FTT found that a refusal by HMRC to give a ruling was not an appealable decision.

In a letter to HMRC, Mr Mather had asked for a decision confirming his view that although he had been charged VAT on the full price of a phone call made by him to Canada (21p), VAT should in law only have been calculated on 50% of the full price (10p), on the basis that the use and enjoyment of the phone call was 50/50 in the UK and Canada. HMRC had responded by letter stating that it was 'HMRC's policy not to get involved in such matters'.

HMRC had applied for an order striking out Mr Mather's appeal, on the grounds that the FTT did not have jurisdiction to hear the appeal because there was no 'decision' by HMRC and Mr Mather did not have sufficient locus standi.

Decision:

The FTT found that HMRC's letter was not a decision. It indicated that it was not providing an answer and HMRC's reference to a general statement of principle could not be construed as a decision. The FTT must therefore decide whether the refusal to give a clear ruling was in itself a decision.

The FTT held that if the customer has an effective right to claim in the civil courts against its supplier, and in default of its supplier, against HMRC, Earlsferry Thistle Golf Club [2014] UKUT 250 is authority for the proposition that 'decision' should not be given an unnaturally wide definition to allow the customer to bring a case in the FTT. The FTT added that there is no requirement under European law that tax disputes are resolved in specialist tax courts.

The FTT also observed that it could not direct HMRC to issue a decision, as this would not be a matter in relation to the conduct or disposal of the proceedings (Tribunal Procedure Rules r 5).

Finally, the FTT found that Mr Mather had no locus standi. He had no financial interest and no legal interest. The fact that 'the public as a whole would be interested in the outcome' was not sufficient.

Comments - The case raised many interesting issues. The most important point is that a taxpayer has limited recourse when HMRC has not made a decision. No right of appeal exists in the absence of a decision and HMRC cannot be compelled to make a decision.

Adam Mather v HMRC [2014] UKFTT 1062

Consultation on Tax Enquiries Closure rules (Lecture B873 – 13.19 minutes)

HMRC issued for consultation a document entitled Tax Enquiries: Closure Rules.

This was published on 18 December 2014 with a closing date for comments of 12 March 2015.

By way of background, an HMRC enquiry will review and if necessary challenge the accuracy of the taxpayer's return. A particular tax return, or subsequent amendment to that return, may only be the subject of one notice of enquiry. Once the enquiry time limits have passed, or an enquiry has been concluded, a taxpayer's return and self-assessed tax bill can only be challenged if a "discovery" is made of a potential loss of tax.

At present only a single closure notice may be issued, when all aspects under enquiry are in a position to be included. The amount of time a particular aspect takes to resolve can vary widely, for example, settlement of a simpler, more mainstream issue which affects only the taxpayer can usually proceed much more quickly than an enquiry involving features which are novel or have a wider impact. The current enquiry framework can therefore be inflexible and constrain HMRC's ability to settle areas of dispute, particularly in complex cases or those involving high-risk or high-value issues. Such enquiries can take a long time to settle and increase uncertainty for the taxpayer whilst the enquiry is open.

The enquiry rules currently prevent HMRC from taking individual aspects of an enquiry into a particular tax return to the Tribunal, unless there is mutual agreement with the taxpayer to refer that issue to the Tribunal. Part of the problem lies with complex cases where there is significant tax under consideration or which involve issues which are novel or have wider impacts. This can mean a long-running issue can prevent final resolution of a simpler issue.

The proposal and safeguards for the taxpayer

The Government proposes to enable HMRC to refer one or more areas of dispute within a wider tax enquiry to the Tribunal with a view to achieving early resolution of those aspects. Any tax found to be due by the Tribunal in respect of those aspects would become payable, whilst other aspects of the tax enquiry would remain open.

It is envisaged that the enquiry process will work as it does currently up until the "joint referral" to the Tribunal. If the taxpayer does not wish to take advantage of mutual referral at that point:

- HMRC would have the option to consider "sole referral" to the Tribunal;
- If HMRC decided to go to the Tribunal, the case worker would apply for senior official authorisation to use the power;
- When the power was authorised a "Tribunal referral notice" would be issued, that HMRC is making an application to the Tribunal for this aspect to be heard. The taxpayer would have 30 days to appeal against the notice;
- Tribunal hears aspect(s) of cases and comes to a judgment;
- Both the taxpayer and HMRC would enjoy the normal rights of appeal against the First Tier Tribunal's decision, namely an appeal on a point of law;
- If HMRC were ultimately successful a "Tribunal referral closure notice" would be issued, following the final outcome of the litigation, once rights of appeal to higher courts have expired or been exhausted. It is envisaged that the same consequences for payment of tax would flow from a "Tribunal referral closure notice" as there would be from a full closure notice.

This would allow HMRC to seek swifter resolution of certain aspects of an enquiry, if necessary through earlier litigation.

In addition, HMRC does have experience of cases where there is no on-going dispute regarding the tax treatment of a specific issue, but that issue cannot be closed while others remain open and under discussion. In this way the taxpayer can gain an advantage by delaying payment. The changes proposed here would offer a remedy to this scenario - HMRC would apply to the Tribunal to close the issue, the tax treatment of which is no longer in dispute and the tax would become payable - but there may be more efficient routes to the same outcome.

Currently, when a tax enquiry is closed, the taxpayer's self-assessment is amended and any additional tax brought into charge. The closure of the enquiry is normally a pre-requisite of any amendment to the Self Assessment. HMRC does have the power to make "jeopardy" amendments during an enquiry, but these are subject to the specific conditions that there is likely to be a loss of tax to the Crown, for example because a company will become bankrupt or an individual will leave the country. A taxpayer may appeal a jeopardy amendment but the appeal cannot be brought before the tribunal until the enquiry is completed. In the meantime, the taxpayer may apply to postpone payment if they have grounds for believing the amount charged is excessive. It is proposed in effect to extend these jeopardy amendment provisions to cover the issue in question whilst the remaining aspects of the enquiry were still in progress but to enable an appeal to be determined before the enquiry is completed.

Amendment to Joint Referral

At present, where a matter is litigated under the "joint referral" route and the final outcome received, the Tribunal's determination does not take effect for payment of tax purposes until HMRC is in a position to issue a closure notice covering the whole enquiry. Although a payment on account may be made in the interim, the government propose altering the current process to enable HMRC to issue a "Tribunal referral closure notice", with payment of tax either from or to HMRC following within 30 days.

Therefore, it is proposed that the legislation regarding payment of tax following joint referral to the Tribunal will be amended, to bring amounts into payment sooner. This amendment will align the payments regarding the joint referral with the sole referral.

Scope of the proposal

The government propose to target the power narrowly at cases or issues involving significant tax under consideration or involving issues which are novel, complex, or have a wider impact, including certain of those which can include tax avoidance. The power would not apply to the majority of tax enquiries and therefore would be limited in its use.

It is proposed that the following taxes which use the formal enquiry process will come within the scope of the proposal:

- Income Tax/NICs;
- Corporation Tax; and
- Capital Gains Tax.

Business Taxation

Capital allowances and the discontinuance of a trade (Lecture B871 – 13.51 minutes)

In the case of *Keyl v HMRC (2014)*, the taxpayer was a self-employed air conditioning engineer trading as 'Changing Climates'. On the advice of his accountant, Mr Keyl turned himself into a company called Changing Climates Ltd which started trading on 1 April 2009. The last accounts for his sole trader business were for the year ended 31 March 2009.

Mr Keyl claimed a 100% annual investment allowance (AIA) in connection with the purchase of a new van in July 2008.

S38A CAA 2001 provides that capital expenditure qualifying for an AIA must be incurred on or after 6 April 2008 (which it was). However, this is cut back by the constraint in S38B CAA 2001 which states that no relief is available in the chargeable period when the business is permanently discontinued. HMRC argued that an AIA was not available on the purchase of a van shortly prior to the incorporation of Mr Keyl's business. Note that a chargeable period for capital allowances purposes is the period for which the trading accounts are drawn up – there was no dispute that this was the year ended 31 March 2009.

HMRC considered that Mr Keyl's sole trader business was permanently discontinued in the year ended 31 March 2009, whereas the trader submitted that the business had continued *after* that date, relying on the maintenance and warranty work which he continued to do in his own name. Alternatively, he argued that, if his trade had been permanently discontinued, this did not happen until Changing Climates Ltd started trading on 1 April 2009 (which was not in the year ended 31 March 2009).

The First-Tier Tribunal relied on the High Court decision in *Sethia v John (1947)*, finding that, when Mr Keyl transferred his business as a going concern to Changing Climates Ltd while retaining trade debtors and continuing, on a personal basis, with the maintenance and warranty obligations to his customers, he had nevertheless discontinued his trade as an air conditioning engineer. What he had retained was not the same trade – he had created a new trade of maintaining systems and dealing with warranty claims.

The Tribunal also rejected Mr Keyl's argument that the original trade had ceased on 1 April 2009 and that this was not within the relevant chargeable period. In this context, the Tribunal observed that Mr Kayl's trade must have been discontinued in the 'scintilla of time before midnight' on 31 March 2009 and that the new company must have started to trade in the 'scintilla of time after midnight', ie. on 1 April 2009.

Mr Keyl was not therefore entitled to an AIA in the chargeable period ended 31 March 2009. Nor, incidentally, would the new company have been eligible to make such a claim, given that it was connected with Mr Keyl (see Ss214 and 217 CAA 2001).

AIA entitlement is a valuable relief (especially with the current 100% limit at £500,000) and care needs to be taken to ensure that the relevant transaction qualifies. Buying plant or machinery in the year of cessation or using a partnership (including an LLP) with a mixture of individual and corporate partners will mean that AIAs are forfeited. In the case of cessations, it is normally a relatively simple matter, in order to ensure that AIA relief is not lost, to continue the unincorporated business for a further period such as one additional month. But it is important that this should be a *new* chargeable period.

Contributed by Robert Jamieson

ITTOIA 2005 provisions

Summary - The FTT found that ITTOIA 2005 provisions which were unambiguous must be given their literal meaning, regardless of the provisions before they were rewritten as part of the tax law rewrite project.

Mr Shirley was UK resident, and was the life tenant and interest in possession beneficiary of two trusts. The appeal related to dividends arising on shares owned by the trust in companies resident in various territories and distributed by the trusts to Mr Shirley. The issue was whether Mr Shirley should be treated as if he had paid tax on the distributions (ITTOIA 2005 s 399). This, in turn, depended on whether s 399 could apply to dividends from non-UK resident companies.

Decision:

ITTOIA 2005 is a rewrite of ICTA 1988. The FTT pointed out that reference to the prior legislation was not permitted unless the rewrite statute was itself ambiguous (Eclipse Film Partners [2013] UKUT 639). The FTT rejected HMRC's contention that precedent legislation could also be used where the interpretation would otherwise lead to injustice or absurdity. HMRC submitted that it was absurd that UK residents eligible under s 399 should enjoy a lower tax rate than those entitled to a credit under s 397 (as grossing up under s 399 only applies to non-residents). However, in the view of the FTT, s 399 was not ambiguous; it must therefore be given a literal interpretation. Parliament may not have intended to amend the law as part of its rewrite, but the clear and unambiguous terms of s 399 must be applied.

Comments - The rewrite clearly created a situation which was different from that of the precedent legislation it aimed to simplify. Yet, in the absence of ambiguity, the FTT was not prepared to go beyond a mere literal interpretation of the new provisions. This case may be relevant to any circumstances where new provisions, which form part of a rewrite statute, produce consequences which may not have been intended by Parliament.

Philip Shirley v HMRC [2014] UKFTT 1023

Casual driver and PAYE

Summary - The FTT found that a takeaway driver was self-employed.

The issue was Mr Liu's liability for PAYE and NIC in respect of two individuals. Mr Liu ran a Chinese takeaway. Following a visit to Mr Liu's premises, HMRC had issued computations of the PAYE and NIC for which it considered Mr Liu to be liable in respect of 'James' and Mr He. Having previously contended that Mr He was the employee of an agency, Mr Liu accepted that he was his employee. As Mr Liu had not submitted form P46 to HMRC, he should have deducted basic rate tax on a cumulative basis; and so Mr Liu's appeal was dismissed in respect of Mr He.

Decision:

As for James (Kerr), applying Ready Mixed Concrete [1968] 1 All ER 433, the FTT accepted that he was a casual delivery driver and not an employee of Mr Liu. He used his own car, covering all costs; and he was not supervised by Mr Liu, who could not require him to make deliveries or prohibit him from making arrangements for deliveries by another driver. The appeal was therefore allowed in relation to Mr Kerr.

Comments - Clearly, Mr Kerr was not an employee, yet HMRC had considered him to be one. Although the amount of tax at stake was not huge, Mr Liu had been right to appeal against HMRC's decision.

Yau Wing Liu v HMRC [2014] UKFTT 1022

Unallowable purpose straddling two accounting periods

Summary - The UT found that a loan relationship which had straddled two accounting periods had an unallowable purpose during both periods.

Until 2002, Fidex was an orphan company associated with BNP Paribas. It bought bonds and issued its own commercial paper bearing the same characteristics as the original bonds.

In 2005, BNP Paribas implemented a tax avoidance scheme to create a tax loss in Fidex, which could then be surrendered to BNP Paribas. BNP Paribas bought the shares in Fidex, which issued four classes of preference shares matching the issued bonds. Fidex then switched from UK GAAP to IFRS accounting standards. As a result of the switch, neither the bonds, nor the preference shares appeared on Fidex's balance sheet, as the preference shares cancelled the economic qualities of the bonds. Under FA 1996 Sch 9A para 19A, this €84m reduction in the carrying value of the bonds constituted a debit under the loan relationship rules, giving rise to a trading loss — without an actual economic loss.

HMRC had claimed throughout its enquiry, and in its closure notice, that no para 19A difference existed. However, at the appeal stage, it raised a new argument; namely that the debit should not be allowed, as the loan relationship had had an unallowable purpose (FA 1996 Sch 9 para 13).

Decision:

Applying the principles established in Tower MCashback [2011] UKSC 19, the UT found that key to the case was 'the subject matter of the enquiry' — the admissibility of the debit. The specific grounds for challenging could evolve during the appeal. Fidex's appeal against HMRC's entitlement to raise a new ground was therefore dismissed.

The UT also found that Fidex had an additional purpose for holding the bonds, which was to obtain a large debit. This was a main tax avoidance purpose and therefore an unallowable purpose. The fact that Fidex had retained the bonds for other purposes as well did not displace this conclusion for 2004. The UT also found that the scheme would not have worked if the bonds had not been held on 1 January 2005. Furthermore, the FTT's finding that Fidex had had an unallowable purpose for a 'scintilla temporis' (a moment of time) at the outset of 2005 was sufficient to establish an unallowable purpose in 2005.

Comments - This case focuses on a less explored aspect of the concept of 'unallowable purpose' — its duration. It establishes that a 'scintilla' of time is enough; and, perhaps more importantly, that a purpose cannot exist one minute and be gone the next. The application of Tower MCashback when identifying the subject matter of an enquiry may also be a useful reference. HMRC can come up with new grounds, provided that the actual subject matter of the enquiry or appeal does not change.

Fidex v HMRC [2014] UKUT 0454

Not enough detail

Summary – The Tribunal found that the claimed expenditure had not been proved

After an enquiry on the disposal of a residential property included in the taxpayer's 2005/06 self-assessment tax return, HMRC amended her liability to include capital gains tax on the sale.

The taxpayer appealed, claiming a deduction for capital allowances on improvements carried out on the property.

She emailed a copy of an invoice to the First-tier Tribunal.

Decision:
The judge said it was clear the invoice related to building works but it did not state to whom the invoice was issued or the property where the work had been done. Even if it were genuine, without information it was not enough to establish that the expenditure had been incurred.

The taxpayer's appeal was dismissed.

Comments – It might be a statement of the blindingly obvious but if you cannot prove expenditure you cannot qualify for the relevant tax provisions. It is surprising that cases like this get to the Court system.

J B Williams v HMRC TC4144

Carry forward of business losses

Summary - The FTT found that an optician that had switched from running a franchise shop to working in a locum capacity as a self-employed dispensing optician was not entitled to carry forward losses.

Mr Amah had been a franchisee of Dollond & Aitchison running an optician's business. He employed an ophthalmic optician, in compliance with both the franchise agreement and the rules of the Association of British Dispensing Opticians.

The franchise ceased on 3 April 2009 and Mr Amah sought to carry forward losses to 2009/10 (ITA 2007 s 83). On 1 June 2009, he started self-employment as a locum dispensing optician from his home, undertaking work under contract for services with established opticians. HMRC refused the claim for carry forward, pointing to the change of location of activities, the time gap between them and the disparate nature of the two businesses.

Decision:

The FTT found that the franchise had been primarily the carrying out of a trade (as set out in the franchise agreement), even though it involved, as part of the trade, the exercise by Mr Amah of his profession as a dispensing optician. By contrast, the locum work undertaken by Mr Amah was the exercise of a profession. Furthermore, the recipients of his services had changed — from patients before to opticians' businesses afterwards — and so had the location of his activities. Finally, the fact that Mr Amah was prohibited from serving the needs of his old clients also suggested a substantial change.

Comments - Interestingly, the FTT observed in its final remarks that the change from a trading activity to a professional one may not necessarily be inconsistent with the carry forward of losses. Such carry forward was not possible in the present case because one activity had ceased and another started.

Individuals might recognise the name of the appellant as it was the subject of another hearing at the FTT in July 2013 when the issue related to whether a late appeal could be made because of misleading advice by HMRC.

Harold Leslie Amah v HMRC [2014] UKFTT 1084

VAT

Last minute changes to MOSS confirmed (Lecture B875 – 12.17 minutes)

Background

Legislation was included in Finance Act 2014 to tax intra-EU business to consumer (B2C) supplies of the following services according to the EU country (Member State to quote the phrase used by HMRC) where the customer is located:

- broadcasting services
- telecommunications services
- e-services (sometimes referred to collectively as 'BTE services')

These services were taxed in the supplier's country until 31 December 2014 – the aim of the new rules from 1 January 2015 is that these services are taxed fairly in the Member State of consumption.

Note – the digital economy is one of the fastest growing sectors in the UK – it is estimated that there are 270,000 businesses involved in making online sales, 40% more than first anticipated. It is also a sector that is predicted to grow even further in the future. According to the Entertainment Retailers Association, digital sales of music, video and games exceeded £1bn for the first time in 2012, a growth of 11% over 2011.

Example 1

Music Ltd is based in the UK and sells music downloads to a range of customers in different EU countries – the customers are all private individuals ie non-business customers (B2C). Until 31 December 2014, the place of supply was UK, and sales were subject to 20% UK VAT, assuming Music Ltd is VAT registered or liable to be registered. From 1 January 2015, the supply became subject to VAT based on where the customer is located and receiving the supply – so a customer in France will be charged 20% French VAT by Music Ltd, and this tax will need to be declared to the French tax authorities. The income will be outside the scope of UK VAT – the place of supply is France.

What are 'e-services'?

The 1 January 2015 rule change only applies to e-services that are electronically supplied.

An e-service includes things like:

- images or text, such as photos, screensavers, e-books and other digitised documents
- music, films and games, including games of chance and gambling games, and of programmes on demand
- on-line magazines
- website supply or web hosting services
- distance maintenance of programmes and equipment
- supplies of software and software updates
- advertising space on a website

What is meant by electronically supplied?

This covers e-services which are automatically delivered over the internet, or an electronic network, where there is minimal or no human intervention. In practice, this means situations where the sale of the digital content is entirely automatic eg a customer clicks the 'buy now' button on a website and the content downloads onto their device or the customer receives an automated e-mail containing the content

All e-services that are electronically supplied in the ways outlined above are categorised as 'digital services' and are covered by the rule change.

Will a UK business covered by the new rules need to VAT register in each different EU country where it has B2C customers?

To save the need for businesses affected by these changes having to register for VAT in other Member States, a Mini One Stop Shop (MOSS) was introduced on 1 January 2015. This is an IT system that gives businesses the option of registering in just the UK and accounting for VAT due in other EU countries using a single return submitted to HMRC. The MOSS returns are submitted electronically on a calendar quarter basis with all tax paid electronically as well. The deadline date is 20 days after the end of each calendar quarter.

Registration for MOSS by businesses currently below the UK VAT Registration threshold (£81,000)

If a UK business sells digital services (B2C) to a customer in another EU member state, it must account for VAT to the tax authorities in that member state and at that member state's VAT rate.

A problem that was evident until HMRC issued **Business Brief 46/14 on 10 December 2014** was that a business could only get a MOSS registration if it already had a UK VAT number. This created a problem for businesses not registered in the UK (trading below the registration threshold), effectively meaning they either had to VAT register and account for output tax on all of their UK taxable sales (not good news if they mainly sell to customers unable to claim input tax) or instead get a separate VAT number in each Member state where B2C digital sales are made. However, this problem has now been solved because HMRC will allow a business to obtain a UK VAT number (to get a MOSS registration) without having to account for tax on its UK sales as long as these are less than the VAT registration limits.

Who will this affect?

These simplified VAT registration arrangements will only be available to a business if:

- It is a UK-based supplier of digital services
- It wants to use the VAT MOSS
- its UK taxable turnover is below the UK-VAT registration threshold (currently £81,000)

How will this work?

If a business makes taxable supplies of digital services to customers in other EU member states (B2C), and its UK taxable turnover is below the UK VAT registration threshold, it may use the VAT MOSS to account for the VAT due in other EU member states but it will not need to account for and pay VAT on sales to its UK customers.

In these circumstances, it must:

- apply for UK VAT registration (see below)
- restrict any VAT refund claims it submits to HMRC to amounts directly attributable to its cross-border EU sales activities on which it will be accounting for VAT through MOSS (see Reclaiming VAT on expenses and purchases below)

Applying for VAT Registration

When applying for VAT registration, the business should select:

- search by business activity and then enter digital services in the following text box
- it will then be directed to select the business activity entitled supplies of digital services (below UK VAT threshold) under MOSS arrangements

Reclaiming VAT on expenses and purchases

As the business will not be charging VAT on its UK sales, any VAT reclaim on business expenses and purchases (see below) must be either wholly attributable to its cross-border digital service supplies accounted for through MOSS, or only that proportion which is attributable to those sales.

For example, a business might purchase a computer which is wholly used for business purposes but if 60% of its sales are UK sales, and 40% of its sales are to customers in other EU member states, it would be able to recover 40% of the VAT charged on the purchase of the computer.

Completing UK VAT returns

Unless a business wishes to claim input tax, as explained in the previous section, it will enter '0' in every box on the return. If it wants to reclaim VAT in relation to EU sales, it should complete boxes 4, 5 and 7. The tax due on digital sales made in other EU countries will then be declared on the quarterly MOSS returns as a separate process

Contributed by Neil Warren

Reasonable steps

Summary – The Tribunal held that periodic checks on a customer's VAT status were sufficient.

The taxpayer, a VAT-registered business, sold agricultural equipment. The issue under appeal concerned supplies to a customer in the Republic of Ireland. The sales were zero-rated on the basis that the goods had left the UK and the customer, F, was VAT registered in Ireland. However, F had deregistered from Irish VAT in October 2010, as a result of which HMRC treated all sales after that date as standard-rated.

HMRC said the taxpayer had not made sufficient checks to ensure the customer was registered and that it was not entitled to zero-rate the supplies. They raised an assessment for under-declared output tax of £87,158.

The taxpayer appealed.

Decision:

The First-tier Tribunal believed the taxpayer had taken "reasonable steps" to ensure the customer was VAT registered in Ireland, as required by HMRC Notice 725 (paragraph 4.2).

The tribunal judge said there was no reason for the taxpayer to question whether the customer was still VAT registered. The trade between the taxpayer and the customer would put his turnover at well above the Irish registration threshold and it paid its bills on delivery.

The judge decided that a review of the customer's VAT status every two or three years (as carried out by the company) was adequate.

The taxpayer's appeal was allowed.

Comments - Neil Warren, independent VAT consultant, said: "This was a worrying case but with a good outcome. Despite the internet opportunities now available to check a customer's overseas VAT status through websites such as Europa, a supplier cannot be expected to carry out lengthy enquiries into a customer's registration arrangements when there does not seem any valid reason why he is not registered. However, as a warning, it is important that a UK supplier carries out periodic checks to ensure that EU customers are still VAT registered in their country to ensure problems are not encountered on future HMRC visits."

Fleming Agri-Products Ltd v HMRC TC4077

Pilates & private tuition exemption

Summary - The FTT found that the teaching of pilates did not fall within the private tuition exemption.

Miss Hocking contended that the teaching of pilates should be exempt, as a supply of private tuition 'in a subject ordinarily taught in a school or university' (VATA 1994 Sch 9 Group 6 item 2). She argued that pilates offers greater educational value than traditional sports, as it requires a comprehensive understanding of the mechanics of the body. For six years, she had taught pilates for the BA Dance degree at the University of Surrey. Additionally, the FTT accepted evidence that pilates is taught in many secondary schools in England (although no percentage was available) and as part of dance training courses.

Decision:

Referring to Haderer (C-434/05), the FTT observed that to fall within the exemption, the activity must be one in which 'instruction is commonly given' in schools or universities. The FTT also noted that the teaching of pilates in schools and universities was educational in character and that this also applied to Miss Hocking's tuition; it involved the transfer of knowledge and skills. However, the FTT was not persuaded by the evidence that such teaching could be regarded as 'commonly' or 'ordinarily' carried on.

Comments - The case may be relevant to many private tutors. It confirms that in order to qualify for the exemption, they must show that the courses they are teaching are 'commonly' taught in schools or universities. Obtaining such evidence may often be challenging.

Christine Joy Hocking v HMRC [2014] UKFTT 1034

Zero rating of military supplies

Summary - The FTT found that the provision of military equipment was not zero rated.

The issue was whether supplies of military equipment to the US government for onward sale to the governments of Poland and Greece were zero rated under VATA 1994 Sch 8 Group 13 item 2. This, in turn, depended on whether the arrangements under which the sales were made amounted to 'international collaboration arrangements'. Under the foreign military sales programme (which has the stated purpose of supporting US foreign policy and national security objectives), the US government can enter into formal contracts with other governments for the sale of military hardware, which it can source from its own suppliers for onward sale.

Decision:

The FTT observed that to fall within the zero rating exemption, the arrangement must be between the UK government and another government. The foreign military sales programme, as a unilateral scheme established by the US, could not satisfy the requirement. Additionally, the FTT found that the sales were not made under an 'international collaboration agreement' for two reasons.

First, the UK was not party to any defence project to which the sales related, as the arrangement was between the US on the one side and Poland and Greece on the other. Second, the sale documentation did not require the UK to relieve the project from taxation costs, and this was a requirement for an international collaboration agreement to exist for the purpose of the provisions (note 1(b)).

Comments - The zero rating exemption for the supply of equipment under a defence project is of rare application. This case is a useful reference for any trader wishing to avail itself of this very narrow exemption.

Goodrich Corporation v HMRC [2014] UKFTT 1029

Relevant charitable purpose

Summary - The FTT found that a sports pavilion did not have the characteristics of a village hall, so its construction was not zero rated.

The issue was whether a building was to be used for a 'relevant charitable purpose', so that its construction was zero-rated (VATA 1994 Sch 8 Group 5).

Decision:

The FTT found that the facilities provided by The New Deer Community Association were for the benefit of the local community as a whole. The FTT noted, however, that the local football club was responsible for the cleaning and maintenance of the new pavilion, which made it different from a village hall. Furthermore, there was little evidence of the pavilion being used by other organisations.

Additionally, the building had been built as a sports pavilion; and, other than a small meeting room, the only open space was the entrance foyer which was designed to allow parents to watch their children playing football. This was not a space similar to a village hall.

The FTT agreed with the terms of HMRC's revised notice that to meet the legislation test, a 'principal feature would be a large multipurpose hall where members of different households could meet to undertake shared activities'.

The FTT concluded that only the small meeting room/kitchen could be used by the whole community and so relief was granted only in respect of that area.

Comments - There are many cases which focus on identifying a 'relevant charitable purpose' in order to obtain the zero rating exemption for construction services. The specificity of this case was that the key issue was whether a building bore the characteristics of a village hall.

The New Deer Community Association v HMRC [2014] UKFTT 1028

Listed buildings & separate garages

Summary - The FTT found that the reconstruction of a garage was not an alteration to a protected building.

Killiganoon Manor is a listed building, An existing garage adjacent to the house was demolished and rebuilt as part of works under a listed building consent. The issue was whether the supplies made in providing the new garage were 'in the course of an approved alteration of a protected building' (VATA 1994 Sch 8 Group 6 item 2), so that they were zero rated. The garage seemed to have been built in the 1980s. If the works were a 'substantial reconstruction' of the then protected building, the garage would be included in the 'protected building', regardless of the fact that note 10 excludes buildings of a 'separate form'. Furthermore, the demolition and reconstruction of the garage could be called an alteration of the protected building. This was because the protected building would have been the house and the garage; and the works to the garage would be alterations to the whole.

Decision:

The FTT found, however, that the building of the garage had not been part of a substantial reconstruction of Killiganoon Manor in the 1980s, as the main house had not been affected by the works.

Comments - Although zero rating for protected buildings was abolished with effect from 1 October 2013, this case may still be relevant to works carried out prior to that date, particularly when works to a separate building are involved.

AD Trevivian v HMRC [2014] UKFTT 1011

Concession is taxable

Summary – The tribunal held that the grant of the catering concession was a taxable supply of parking and the right to trade.

Fareham Borough Council permitted an ice-cream business to park its van in a specifically marked bay in the Salterns Car Park and trade from that site. The council claimed that the supply was exempt under VATA 1994, Sch 9 group 1. HMRC disagreed, saying there was no licence to occupy land so the exemption did not apply. The council appealed.

Decision:

The First-tier Tribunal said the catering concession was a means of allowing the supply, and gave the ice-cream van owner the right to sell ice creams.

On the space allocated to him, the tribunal found that anyone could park in the space and, although the owner could ask the person to move, he was more likely to park in a different space.

There was therefore a defined area that could be used in return for payment, but there was no guarantee that it would be available. The payment would still be required, even though the owner had no power to exclude others from using the space.

The tribunal agreed with HMRC that the grant of the catering concession was a taxable supply of parking and the right to trade.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, said: “The key tests to identify the features of a land-related transaction in HMRC's own public notice 742 seemed to support the taxpayer's view that the supplies were exempt but, as the tribunal pointed out, the notices only give HMRC's interpretation of the law. They are not legally binding or relevant as far as the tribunal's analysis is concerned. Another interesting matter raised by the appellant was that HMRC accept that a pitch fee paid to park a vehicle at a car boot sale qualifies for exemption but that was an irrelevant fact in this case, which was focusing only on the specific arrangement between the council and taxpayer.”

Fareham Borough Council (TC4129)

VAT: conditions for the right to deduct input tax

Summary - The CJEU found that the right to deduct input tax is only subject to substantive requirements. Non-compliance with formal requirements should not result in the loss of the right to deduct.

Idexx had effected intra-Community acquisitions from a French company and a Dutch company, but had failed to account for acquisition VAT.

Following an inspection, the Italian tax authority had taken the view that those transactions were intra-Community acquisitions subject to the reverse charge procedure. It had therefore assessed Idexx for the acquisition VAT — and imposed a 100% penalty. However, Idexx was unable to reclaim any input tax because it had failed to carry out the formalities required by national law.

The issue was therefore whether the right to deduct input tax (Sixth Directive art 18(1)(d)) is subject to formal requirements or to substantive requirements, failure to comply with which results in the loss of that right.

Decision:

The CJEU observed that the right of taxable persons to deduct VAT is a fundamental principle of the common system of VAT; and that the formalities laid down by member states for the exercise of that right should be limited to ensuring that the relevant tax authority has all the information it requires. In the present case, the Italian tax authority had all the information necessary to establish that the substantive requirements had been satisfied.

Comments - Following the CJEU's judgment, the Italian court will very probably find in favour of Idexx. More generally, the case will be relevant to any trader faced with a refusal by HMRC to allow a deduction of input tax on the ground of non-compliance with formal requirements.

Idexx Laboratories v Agenzia delle Entrate (C-590/13)

Single supply of wedding services

Summary - The FTT found that a company was providing a single standard-rated supply of wedding related services and not a supply of land.

Willant Trust owns Ramster Hall, a stately home where both civil weddings and wedding receptions are held. HMRC considers that Willant Trust makes a single standard-rated supply of wedding related services. Willant Trust contends that it makes exempt supplies of land.

Decision:
Applying Secret Hotels 2 [2014] UKSC 16, the FTT set out to establish the 'essential subject matter of the contract'. Willant Trust's statements on its website suggested that it would provide organisation and planning help with the wedding, beyond the mere provision of a list of suppliers. As these representations were accompanied by testimonials and any problems and complaints were to be dealt with by Willant Trust, the FTT concluded that the 'reasonable informed observer' would find that the contract included a term that the Willant Trust would help with the planning and organising of the wedding.

Applying Card Protection Plan, the FTT also found that, from the point of view of the client, all the elements of the service formed a single indivisible economic supply which it would be artificial to split.

The FTT then had to decide whether Willant Trust was making supplies of land. It noted that in order to come within the exemption (VATA 1994 Sch 9 group 1), clients would need to have the right to occupy the property as if they were the owners, excluding other persons from its enjoyment. This was not precluded by the fact that the halls could only be used for weddings. However, the fact that clients could only use the caterer and DJ designated by Willant Trust took the supplies out of the exemption. Other restrictions, for instance on the right to use amplification, also constituted interference with the rights of the clients to use the property 'as if they were the owners'. Moreover, Willant Trust could enter the halls during events, suggesting that other persons could not be excluded.

Finally, it was clear that Willant Trust was not engaged in the passive activity of property letting, but was supplying services.

Comments - The case deals with many complex VAT issues. In so doing, it confirms that: (1) what matters is the nature of the relationship between the parties; (2) single economic supplies of services should not be artificially split; and (3) a supply of land subject to stringent conditions may take it out of the exemption.

Willant Trust v HMRC [2014] UKFTT 1083

Right to use websites not a face value voucher

Summary - The FTT found that the right to access various websites was not a face value voucher.

Brightsolid offered access to genealogy websites, either by way of subscription or on a pay as you go basis. A lump sum was paid, for which vouchers were issued, giving opportunities to download information; these had to be used within a certain time. Brightsolid was appealing for a repayment of VAT on vouchers which had not been redeemed within the time limit. It contended that the vouchers were 'face value' vouchers for the purpose of VATA 1994 Sch 10A para 1 and that therefore no supply had taken place at the time of their issue.

Decision:

Agreeing with HMRC, the FTT found that customers purchased a package including the means to access the websites, as well as facilities to search them and download information. The supply therefore took place at the time of the purchase of the vouchers. The FTT added that the vouchers were not face value vouchers. Their price could vary depending on the way they were purchased and it was impossible to calculate the value of the balance of unused units. The document issued on purchase of the vouchers was therefore no more than a receipt.

Comments - The difficulties of identifying face value vouchers, which fall within the scope of VATA 1994 Sch 10A para 1, have led to a plethora of litigation. Since 10 May 2012, VAT is due on the issue of face value vouchers in any event, removing the key reason for litigation in this respect. This case remains relevant for vouchers issued before 10 May 2012.

Brightsolid Online Technology Ltd v HMRC [2014] UKFTT 1040

Relevant residential purpose and serviced apartments for the elderly

Summary - The FTT found that a building designed for the elderly, and which provided various services adapted to their needs whilst enforcing certain rules, was an institution for the purpose of 'relevant residential purpose'.

TGH was a wholly owned subsidiary of a charity which provided accommodation for elderly 'in need'. TGH had entered into a design and build contract with the charity for the construction of a two-storey building, comprising 18 self-contained flats which the charity offered to elderly 'in need'.

It contended that the building was used for a 'relevant residential purpose', so that the construction services were zero rated (VATA 1994 Sch 8 Group 5 item 2(a)) on the basis that the building was 'a home or other institution providing residential accommodation with personal care' (note 4(b)).

HMRC considered, however, that the building was designed as a number of dwellings (VATA 1994 Sch 8 Group 5 item 2(a) note 2). Although HMRC's decision also meant that the construction services were zero rated, it had implications for the treatment of the site as a whole and TGH appealed.

Decision:

The FTT found that the building was an institution; although its residents enjoyed a degree of autonomy, they had to comply with many rules (for instance, they could not redecorate the flats, or invite guests overnight). Additionally, as licensees, the residents had no occupational rights; they could be moved between flats or be asked to vacate the building. The FTT added that a degree of compulsion of the residents was not necessary to establish the existence of an institution.

Finally, the FTT also found that the building provided personal care adapted to the needs of the residents. Some may require washing and feeding, while others only needed the security, maintenance and laundry services.

Comments - By suggesting that a degree of flexibility is required when ascertaining whether a building falls within the definition, the case may be very helpful. In particular, the notion that an institution may exist solely on the basis of a framework of reasonably light rules, devoid of any compulsion, may be relevant to many other establishments.

TGH (Construction) Ltd v HMRC [2014] UKFTT 1039

VAT: decrease in consideration

Summary -The FTT found that no decrease in consideration had taken place after the supply.

The issue was whether a price adjustment which Rio Tinto had made in relation to management and administration services supplied to a group pension fund was a 'decrease in consideration' for the purpose of the Value Added Tax Regulations, SI 1995/2518, reg 38.

The dispute related to pension investment costs incurred by Rio Tinto in the form of salary and related charges. Rio Tinto contended that these costs included administration costs, which should not have carried VAT when recharged to the fund. Yet from 1973 to 2010, it had mistakenly charged VAT in respect of these expenses. It was in relation to these administration expenses that the alleged price adjustment was made. The Fleming [2008] UKHL 2 claim for repayment was not pursued, pending resolution of this appeal.

Decision:

The FTT had to consider the economic and commercial reality of the price adjustment. It noted that reg 38 applies to situations where, after the agreement for the supply has been made and performed, the consideration for the supply is changed. The reduction in consideration need not necessarily flow from a term or breach of a term in the original supply agreement.

In this case, there had been no change in circumstances leading the parties to think that the original (net of VAT) consideration was either wrongly calculated or should be reduced. Instead, Rio Tinto considered that VAT had been overcharged on some of the supplies. The price adjustment was therefore an artificial mechanism to procure a VAT credit, and reg 38 was not in point.

Comments - The case contains some useful practical examples of the circumstances in which the FTT considers that reg 38 should apply. In all the examples, the view of the parties as to the right level of consideration changes after the supply.

Rio Tinto v HMRC [2014] UKFTT 1059

Zero-rating and phased construction

Summary - The FTT found that a construction project carried out in phases did not fall within the scope of zero-rating.

The issue was whether redevelopment work undertaken for a college was zero-rated under VATA 1994 Sch 8 Group 5 item 2, as the building was to be used for a 'relevant charitable purpose'.

The project had been divided into phases and a long lapse of time had passed between the completion of the first two phases and the completion of the third phase; although planned, this third phase had depended upon the availability of funding. The first two phases were dedicated to the construction of a new performing arts centre, together with a new art and media department. These new buildings were to be used, together with the original main building of the college, for the indeterminate period from the completion of the first two phases until the completion of the third phase. During that period a covered walkway was in place connecting the new building with the original main building of the college. The works carried out in the first two phases were therefore works in the course of an extension to the original main college building, excluded from zero-rating.

Finally, the building constructed in the third phase abutted the buildings constructed during the first two phases and included the new entrance hall to the college, as well as a sports hall and a learning resources department.

Decision:

The FTT concluded that this building was an extension of the buildings constructed in the first two phases and so was also excluded from zero-rating.

Comments - On completion of the last phase, the plan was for the original buildings to be demolished. Yet, because construction had been in phases, each of the buildings constituted an extension, so that the related construction services fell outside the scope of zero-rating.

Central Sussex College v HMRC [2014] UKFTT 1058

Revenue and Customs Brief 47 (2014): changes to the Intrastat arrival threshold from 1 January 2015

The purpose of this brief is to explain how businesses trading in goods with other EU member states, who are required to submit Intrastat arrival (EU imports) declarations, will be affected by a change to the Intrastat arrivals threshold from 1 January 2015.

Who is it relevant to?

VAT-registered businesses that are required to submit declarations of arrivals trade received from other EU member states.

Changes to Intrastat arrivals threshold from 1 January 2015

From 1 January 2015 the exemption threshold for arrivals will increase from £1,200,000 to £1,500,000.

The exemption threshold for dispatches (EU exports) remains unchanged at £250,000.

Background

Information on trade in goods between EU member states is collected by the Intrastat system. Member states are required by EU legislation to review annually their Intrastat exemption thresholds, below which businesses involved in such trade aren't required to submit Intrastat declarations.

All VAT-registered businesses are required to declare the value of their intra-EU trade in goods on their VAT returns. Businesses with an annual intra-EU trade above the thresholds (applied independently to arrivals and dispatches) are required to provide more detailed statistical returns.

The value of the thresholds are reviewed annually by HM Revenue and Customs (HMRC) to:

- accurately match the percentage coverage of the value of intra-EU trade required by EU legislation
- ensure that the number of businesses required to submit monthly information is minimised

Following the annual review HMRC is able to increase the arrivals threshold from £1,200,000 to £1,500,000. The same review calculated that we should maintain the dispatches threshold at £250,000 to ensure we maintain the legislated percentage coverage for dispatches.

R&C Brief 49 (2014): VAT - Prompt Payment Discounts (Lecture B874 – 11.59 minutes)

Introduction

This brief provides guidance on what to do when you raise or receive a VAT invoice offering a PPD from the 1 April 2015 when the change takes effect.

Who is it relevant to?

Suppliers who offer and customers who receive PPD where an invoice is issued.

Background

A PPD is an offer by a supplier to their customer of a reduction in the price of goods and/or services supplied if the customer pays promptly; that is, after an invoice has been issued and before full payment is due.

Before the change, suppliers making PPD offers are permitted to put on their invoice, and account for, the VAT due on the discounted price, even if the full price (i.e. the undiscounted amount) is subsequently paid. Customers receiving PPD offers may only recover as input tax the VAT stated on the invoice.

After the change, suppliers must account for VAT on the amount they actually receive and customers may recover the amount of VAT that is actually paid to the supplier.

The change took effect on 1 May 2014 for supplies of broadcasting and telecommunication services where there was no obligation to provide a VAT invoice. For all other supplies the change takes effect on 1 April 2015.

Guidance

Suppliers:

a) on issuing a VAT invoice, suppliers will enter the invoice into their accounts, and record the VAT on the full price. If offering a PPD suppliers must show the rate of the discount offered on their invoice (Regulation 14 of the VAT Regulations 1995 (SI 1995/2518)).
b) the supplier will not know if the discount has been taken-up until they are paid in accordance with the terms of the PPD offer, or the time limit for the PPD expires.
c) the supplier will need to decide, before they issue an invoice, which of the processes below they will adopt to adjust their accounts in order to record a reduction in consideration if a discount is taken-up.
d) when adjustments take place in a VAT accounting period subsequent to the period in which the supply took place the method of adjustment needs to comply with Regulation 38 of the VAT Regulations 1995 (SI 1995/2518).
e) suppliers may issue a credit note to evidence the reduction in consideration. In which case, a copy of the credit note must be retained as proof of that reduction.
f) alternatively, if they do not wish to issue a credit note, the invoice must contain the following information (in addition to the normal invoicing requirements):
   - the terms of the PPD (PPD terms must include, but need not be limited to, the time by which the discounted price must be made).
   - a statement that the customer can only recover as input tax the VAT paid to the supplier.

Additionally, it might be helpful for invoices to show:

- the discounted price
- the VAT on the discounted price
- the total amount due if the PPD is taken up.

g) if a business has adopted the option at (f), the VAT invoice, containing appropriate wording as described above, together with proof of receipt of the discounted price in accordance with the terms of the PPD offer (e.g. a bank statement) will be required to evidence the reduction in consideration, and the reduction to the supplier's output tax (in accordance with Regulation 38 of the VAT Regulations 1995).

h) we recommend businesses use the following wording on the invoice:

"A discount of X% of the full price applies if payment is made within Y days of the invoice date. No credit note will be issued. Following payment you must ensure you have only recovered the VAT actually paid."

i) if the discounted price is paid in accordance with the PPD terms, then the supplier must adjust their records to record the output tax on the amount actually received.

If the full amount is received no adjustment will be necessary.

Customers:

On receiving an invoice offering a PPD a VAT registered customer may recover the VAT charged

As adjustments may take place in a VAT accounting period subsequent to the period in which the supply took place the method of adjustment needs to comply with Regulation 38 of the VAT Regulations 1995 (SI 1995/2518). In practice this will mean:

a) if the customer pays the full price they record it in their records and no VAT adjustment is necessary.

b) if the customer pays the discounted price in accordance with the PPD terms on receipt of the invoice they may record the discounted price and VAT on this in their accounts and no subsequent VAT adjustment is necessary.

c) if the customer does not pay when the invoice is first issued, they must record the full price and VAT in their records as shown on the invoice. If they subsequently decide to take-up the PPD then:

- if they have received an invoice setting out the PPD terms which states no credit note will be issued they must adjust the VAT in their records when payment is made. They should retain a document that shows the date and amount of payment (e.g. a bank statement) in addition to the invoice to evidence the reduction in consideration.
- if the supplier's invoice does not state that a credit note will not be issued, the customer must adjust the VAT they claim as input tax when the credit note is received. They must retain the credit note as proof of the reduction in consideration.

Imports

The legislation in relation to prompt payments on imports has not changed.

Payments outside PPD terms

Where a supplier receives a payment that falls short of the full price but which is not made in accordance with the PPD terms it cannot be treated as a PPD. The supplier must account for VAT on the full amount as stated on the invoice. If the amount not paid remains uncollected it will become a bad debt in the normal way. If a price adjustment is agreed later, then adjustment must be made in the normal way e.g. a credit note.