Tolley®CPD

February 2015

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Contents

Personal Tax **4**

Wife was a partner not an employee 4
Consultation on a minimum claim period for the RBC 4
Remittance basis changes (Lecture P876 – 12.24 minutes) 7
Pensions – A new era (Lecture P880 – 17.13 minutes) 8

Capital Taxes **12**

Private residence relief not available as occupation not sufficient 12
What is a 'just and reasonable' apportionment? (Lecture P877 – 15.28 minutes) 12
Goodwill on incorporation (Lecture B876 – 16.12 minutes) 14
Is it a qualifying corporate bond (QCB)? (Lecture P872 – 16.54 minutes) 16
Deferred entrepreneurs' relief on invested gains (Lecture B878 – 14.17 minutes) 17
CGT pooling – Practical issues to catch out the unwary (Lecture P879 – 11.54 minutes) 19
SDLT planning and s 75A 22
Inaccuracy in an IHT return 23

Administration **24**

Surcharges stand 24
Not for registrar to decide 24
Not fit and proper 25
Witness expenses 26
Postponement application 27
Careless inaccuracy in a return 27
Legal professional privilege and search warrants 28
Tax penalties and the Bill of Rights 29
Lack of care 30
HMRC puts forward new measures to tackle persistent tax avoiders 31
HMRC news 32

Business Taxation **33**

Trade of horse ownership had the feel of a hobby 33
Negligence by tax advisers 33
Qualifying trade 34
Was the trade conducted on a commercial basis? 35
Purchase of own shares - Multiple completion contracts (B877 – 22.13 minutes) 35
Disposal of a company and contingent liability 37
FII group litigation: quantum and remedies 38
Unlawful curtailment 39
Deductibility of forex losses 39
Carry-forward of trading losses (Lecture B879 – 11.43 minutes) 40

VAT **41**
Agency and exempt supplies 41
Abusive arrangements 41
What is 'clothing'? 42
Curtailment of right to recover tax unlawfully paid 43
Fraudulent activities and the rights to a deduction/exemption 43
Duty suspended goods 44
Interaction between the BT and GMAC cases 45
Occupancy restriction 45
VAT: single supplies of caravans with verandas 46
Effect of an unlawful extension to a block 47
DIY builder scheme and planning Permission 47
MTIC fraud and knowledge of the Taxpayer 48
VAT: supply of sporting facilities 48
Was the supply of pilot training a supply of services? 49
Rental invoices 50
Bad debt relief (Lecture B880 – 16.46 minutes) 51

Personal Tax

Wife was a partner not an employee

Summary - The FTT found that no employer/employee relationship existed between a husband and a wife working in partnership.

Mr Patel and his wife had run a retail newsagent and a sub-post office in partnership, with Mr Patel being remunerated by the Post Office for his work as sub-postmaster. Mrs Patel was considered by the Post Office to be Mr Patel's employee, as there could not be two sub-postmasters.

The sub-post office side of the business was closed in June 2004 and the Post Office made a payment of over £75,000 to compensate Mr Patel for his loss of office. The payment was made to the joint business account of Mr and Mrs Patel.

Decision:

The FTT had to decide whether Mrs Patel had received any payment for loss of employment. It found that Mrs Patel had not been the employee of her husband, regardless of the position as far as the Post Office was concerned. She was not entitled to a redundancy payment and none had been made to her.

Mr Patel had received the termination payment in his capacity of sub-postmaster. The fact that Mr Patel had made arrangements through the partnership to share this receipt with his wife did not alter its tax status. Mr Patel was therefore liable to income tax, save for the first £30,000, on the whole amount (ITEPA 2003 s 403).

Comments - This case explores the interaction between the relationships of partners and those of employer/employee. It also confirms that, when it comes to identifying employment, facts matter more than labels.

Harikrishna S Patel v HMRC TC4189

Consultation on a minimum claim period for the RBC

At the Autumn Statement 2014 the government announced it would consult on making the claim to pay the remittance basis charge apply for a minimum of 3 years.

Aim of the consultation

This consultation seeks to better understand the reasons why individuals choose not to pay the remittance basis charge each year and why this can change from year to year. It seeks views on how a minimum claim period for the charge might apply but also any alternatives that would also meet the government's objectives.

At the Autumn Statement 2014 the government announced it would consult on making the election to pay the remittance basis charge apply for a minimum of 3 years. This means the remittance basis charge will be payable for three consecutive years, whether or not overseas income and gains are actually remitted into the UK. This would mean, for example, that an individual who has been resident for more than 17 out of 20 years would be committing to pay £90,000 in each of the three years if they chose to claim the remittance basis. It is intended that this minimum claim period will take effect in the next Parliament, from April 2016.

Rationale for the introduction of a new minimum claim period

As well as the economic environment and investment decisions, the decision to make the claim can also depend on how individuals choose to plan their affairs for tax purposes. For example, some wealthy people have sufficient control over their financial affairs that they are able to plan so they don't have to pay the charge each tax year, bringing income and capital gains into the UK periodically so that exposure to the charge is minimised. Some investment products, such as offshore bonds, are marketed to non-UK domiciled individuals to promote this.

The government believes it is fair to ask those non-UK domiciled individuals who claim these remittance basis rules to commit to paying the charge for a minimum period when they have been resident in the UK for sufficiently long to have to pay the charge. It is also mindful that the increases in the remittance basis charge will increase the incentive for some individuals to further structure their affairs so that exposure to the charge is minimised and income and gains are not remitted into the UK.

At present, the charge is paid by more than 5,000 non-UK domiciled individuals each year, with almost 9,000 individuals having paid the charge in total since its introduction in 2008. Almost 3,000 individuals have paid the charge in each year since it was introduced, with a further 1,000 individuals paying the charge in 4 of the 5 years for which data is currently available. Analysis suggests that up to 800 individuals paying the remittance basis charge in 2012-13 had stopped claiming the remittance basis in the past and were now claiming it again. This does not mean that all those individuals are planning their affairs to reduce exposure to the remittance basis charge; it may simply reflect the fluctuation of income and gains or individuals who become temporarily non-resident.

However, it has been suggested to the government that some very wealthy non-domiciles do actively plan their affairs so that they only pay the remittance basis charge every few years. This is likely to be exacerbated by the higher charges announced at Autumn Statement 2014.

Proposed minimum claim period

The government considers a 3 year claim period to be a reasonable minimum period of time for long-term residents to commit to the remittance basis charge. This strikes a balance between the annual claims, which allow a judgement to be made on whether to pay the charge in relation to a particular year, and a lengthier period which would require people to have much greater foresight about their future income and gains.

The government believes this minimum period ensures greater fairness without acting as a significant disincentive to those who wish to come to the UK. The extended claim period could be more difficult for individuals with overseas income and gains that fluctuate significantly particularly where that is outside the person's control but this potential uncertainty is mitigated by a number of factors:

- the claim will continue to be made on the self-assessment tax return, which has a deadline for filing at the end of January of the following year. For example, the return for 2013-14 is due by 31 January 2015. This means individuals will have a good understanding of their income and gains for up to 21 months of the 36 months covered by the claim

- individuals will continue to be able to amend their self-assessment tax returns within 12 months of the statutory filing date, so individuals will be able to change a decision on a claim within that time limit if they choose to do so

- individuals who pay tax on the arising basis will continue to have four years after the end of the tax year in which to claim the remittance basis, which also allows individuals to make a final decision based on a full understanding of their worldwide income and gains in those circumstances if they choose to do so

- The government would welcome views on how to treat subsequent claim periods. There are 2 main options following the first minimum 3 year period:

- the individual could be required to make a claim for the following three years in much the same way as the initial claim. For example, if the final year covered by the initial claim is 2018-19 then the individual could be asked if they wish to make a new claim for the following three years on their self-assessment return for 2019-20, which would mean they will pay the remittance basis charge for 2019-20, 2020-21 and 2021-22

- the claim period could become a rolling period so that the individual is in effect taking an annual decision on the previous three year period once that initial three year claim has passed. For example, if the final year covered by the initial claim is 2018-19 then the individual could make an election for 2019-20 that applies to that year only. If no election was then made for the following year, 2020-21, an election made in a later year would again have to be for a minimum of 3 years; so, a claim in 2021-22 would mean paying the remittance basis charge in 2021-22, 2022-23 and 2023-24

Circumstances when the claim will not span 3 consecutive years

As outlined above, all individuals will continue to be able to amend their self-assessment tax return within the normal time limits for making an amendment if they find that they wish to change their decision to claim for the remittance basis charge for a 3 year period. However, there will be a small number of other circumstances where it would be inappropriate for the full 3 year claim to apply.

These circumstances are:

- if an individual makes a claim but dies during the period then the remittance basis charge may be revoked. For example, if an individual makes a claim covering 2016-17, 2017-18 and 2018-19 but dies during 2017-18 then it would be possible to revoke the claim

- if an individual becomes non-resident during the course of the claim period then any remaining years for the claim period would be held over until they become resident in the UK again, assuming they do so within the next 5 years. This aligns the remittance basis charge with the rules on temporary non-residence for relevant foreign income and capital gains tax purposes. If an individual does not become resident again in those five years then the claim would cease to apply for the remaining years. For example, if an individual makes a claim covering 2016-17, 2017-18, and 2018-19 but becomes non-resident in 2018-19 then the final year of the claim period would be held over, assuming the individual becomes resident in the UK again before the end of 2023-24

Remittance basis changes (Lecture P876 – 12.24 minutes)

The announcement in the recent Autumn Statement that the annual charge is going up to £90,000 for non-UK domiciliaries who wish to access the remittance basis once they have been resident in the UK for 17 out of the last 20 tax years was something of a surprise. Initially, it seemed like a sensible linking with the deemed domicile rule for IHT purposes (see S267 IHTA 1984), but, on further reflection, this is clearly not the case. The proposal in the draft Finance Bill creates a significant anomaly which is illustrated in (b) below.

Illustration 2

Edwige is a wealthy French lady who has been resident in the UK for many years. However, because of her husband's job, she leaves the UK and becomes non-UK resident for three consecutive tax years. She then resumes her UK residence when her husband is posted back to the UK.

On Edwige's return, she will not be liable to the standard £30,000 charge, given that she has not been resident in the UK for seven out of the preceding nine tax years. Nor will she be caught by the higher levy (currently £50,000, but rising to £60,000 for 2015/16 onwards), because she will not have been resident here for 12 out of the last 14 tax years.

But she will be subject to the new £90,000 charge, which also takes effect for 2015/16 onwards, under what the legislation calls 'the 17-year residence test'. It seems absurd to suggest that someone who has not been UK-resident for long enough to pay the entry level £30,000 charge will instead be caught for the top rate liability.

In order to be consistent with the other non-UK domiciliary charges, the test should be 'Have you been resident in the UK for 17 out of the last 19 tax years?'

As one commentator has pointed out:

'That would make complete sense of the regime and, although it would be out of kilter with the IHT rule, that does not really matter. IHT is an entirely different tax with entirely different consequences and that differential gives rise to no anomaly or trap for the taxpayer.'

It remains to be seen whether the Government will make any late adjustment to this proposal.

In addition, the Chancellor has announced that the Government intend to consult about the possibility of make the remittance basis election apply for a minimum of three tax years – at present, the basis of taxation for a non-UK domiciliary can be changed annually.

Contributed by Robert Jamieson

Pensions – A new era (Lecture P880 – 17.13 minutes)

The Taxation of Pensions Act 2014 contains the new legislation regarding how people can withdraw funds from their pension schemes with most of the provisions being effective from 6 April 2015.

Income withdrawals

From the age of 55 policyholders have complete freedom as to how much to withdraw from the fund as well as the timing of those withdrawals. With careful planning income tax liabilities can be minimised

Under the new rules, 25% of each withdrawal will be tax free with the balance being chargeable at the taxpayer's marginal rate of tax in the tax of withdrawal. Where the taxpayer continues working after 55 but maybe with reduced hours, pension funds can be used as a 'top up' income and where possible, withdrawals can be limited to avoid moving into the higher rate tax band.

Unlike annuities, the money withdrawn can be varied to tie into changes in the taxpayer's personal circumstances year on year. In years of high income, less or no money needs to be withdrawn while in years of low income, more money can be withdrawn from the fund.

This flexibility applies to funds that are built up personally as well as funds that are inherited from a previous member of the fund who has died after the age of 75.

Tax rate mismatch

Where higher rate tax relief was obtained on the original contributions put into a scheme, even if the taxpayer remains a higher rate taxpayer, currently they still get more out of their fund than it cost them to put it in.

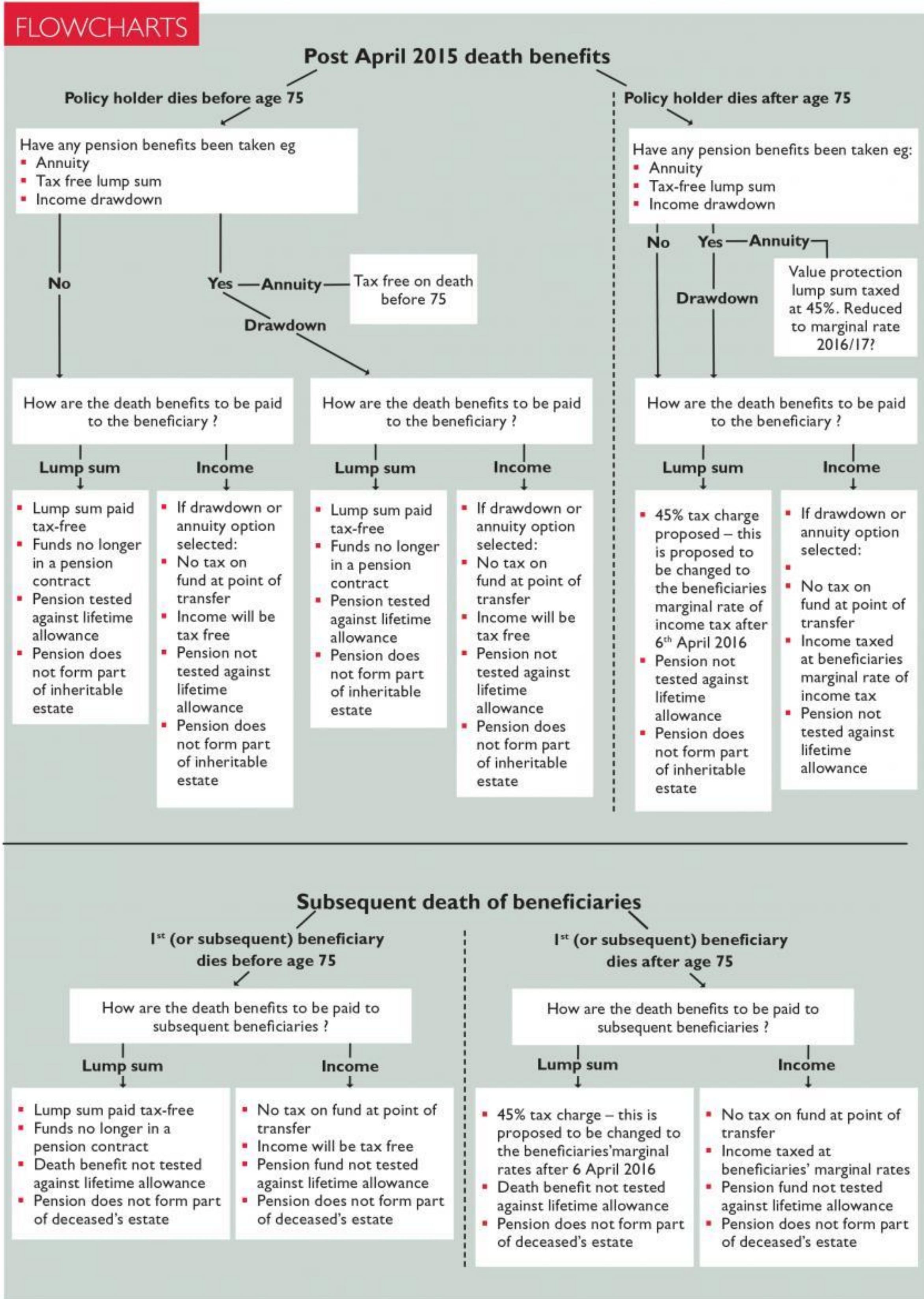
On withdrawal	**Higher rate**	**Basic rate**	**No tax**
Gross contribution	10,000	10,000	10,000
Tax relief when contribution made	(4,000)	(4,000)	(4,000)
(A) Net cost	**6,000**	**6,000**	**6,000**

Fund value	10,000	10,000	10,000
£10,000 withdrawal from fund:			
(B) 25% tax free	***(2,500)***	***(2,500)***	***(2,500)***
Remaining fund withdrawn as income	*7,500*	*7,500*	*7,500*
Tax on fund withdrawn 40%/ 20%/ 0%	*(3,000)*	*(1,500)*	*(Nil)*
(C) Fund withdrawn after tax	***4,500***	***6,000***	***7,500***
(D) Total net withdrawal (B+C)	***7,000***	***8,500***	***10,000***
Overall cash benefit (D–A)	**1,000**	**2,500**	**4,000**

Death benefits

The rules are different depending on whether the taxpayer dies before or after they are 75. The flowcharts illustrated overleaf provide a useful summary of the position and are taken from an article in *Taxation (15 January 2015)*.

These rules assume that the benefits are paid out within two years of the scheme administrator being notified of death and that there is an appropriate expression of wish or declaration of trust in place with regard to the fund.


FLOWCHARTS
Post April 2015 death benefits
Policy holder dies before age 75
Have any pension benefits been taken eg
Annuity
Tax free lump sum
Income drawdown
No
Yes
Annuity
Tax free on death before 75
Drawdown
How are the death benefits to be paid to the beneficiary ?
Lump sum
Income
Lump sum paid tax-free
Funds no longer in a pension contract
Pension tested against lifetime allowance
Pension does not form part of inheritable estate
If drawdown or annuity option selected:
No tax on fund at point of transfer
Income will be tax free
Pension not tested against lifetime allowance
Pension does not form part of inheritable estate
Policy holder dies after age 75
Have any pension benefits been taken eg:
Annuity
Tax-free lump sum
Income drawdown
No
Yes
Annuity
Drawdown
Value protection lump sum taxed at 45%. Reduced to marginal rate 2016/17?
45% tax charge proposed – this is proposed to be changed to the beneficiaries marginal rate of income tax after 6th April 2016
Pension not tested against lifetime allowance
Pension does not form part of inheritable estate
No tax on fund at point of transfer
Income taxed at beneficiaries marginal rate of income tax
Pension not tested against lifetime allowance
Subsequent death of beneficiaries
1st (or subsequent) beneficiary dies before age 75
How are the death benefits to be paid to subsequent beneficiaries ?
Lump sum paid tax-free
Funds no longer in a pension contract
Death benefit not tested against lifetime allowance
Pension does not form part of deceased's estate
No tax on fund at point of transfer
Income will be tax free
Pension fund not tested against lifetime allowance
Pension does not form part of deceased's estate
1st (or subsequent) beneficiary dies after age 75
45% tax charge – this is proposed to be changed to the beneficiaries'marginal rates after 6 April 2016
Death benefit not tested against lifetime allowance
Pension does not form part of deceased's estate
No tax on fund at point of transfer
Income taxed at beneficiaries' marginal rates
Pension fund not tested against lifetime allowance
Pension does not form part of deceased's estate

Careful planning

If a particular fund is not needed to fund retirement it can be left within the pension fund, where it is protected from tax, for the next generation to use. So a higher rate tax year contributing £100,000 over a number of years will save 40% income tax on contributions made and 40% inheritance tax on death. So can the taxpayer control other income sources wherever possible to ensure that the taxpayer manages their marginal rate of tax?

Remember commercial property can be held within a pension fund. Is it worth the taxpayer buying commercial property using fund money to use or to let out?

If the taxpayer's income tax rate is lower than their next generation, it might be worth withdrawing money from the fund to help them out in certain circumstances.

Summarised from an article in Taxation, issue 4484, 15 January 2015 Pensions shake-up

Capital Taxes

Private residence relief not available as occupation not sufficient

Summary- The FTT found that private residence relief from CGT was not available.

Mr Hartland bought a property, obtained planning permission for an extension, completed the works and sold it. Two days later, he acquired another property which he occupied for two years before selling it. He then acquired a third and a fourth property which he then sold.

He claimed that each of the properties had successively been his homes and that they were not assets in which he was trading. However, he accepted that other property transactions entered into around the same time had been in the nature of a trade. HMRC contended that all the property transactions entered into by Mr Hartland had been in the nature of a trade.

Decision:

On the basis of the evidence, the FTT accepted that Mr Hartland had acquired the first two properties with a view to occupying them and that he had indeed done so; no tax was therefore due on their disposal. With regard to the third property, the position was different. Mr Hartland had lived in a static caravan while the property was being rebuilt and he had sold it as a 'newly built' property which had never been occupied. Furthermore, no correspondence had been sent to him at this address.

Comments - Mr Hartland had hoped that by occupying land while it was being redeveloped (and living in a static caravan), he would be able to establish that it was his main residence for the purpose of CGT relief. The case confirms that such occupation is not sufficient.

Trevor Anthony Hartland v HMRC [2014] UKFTT 1099

What is a ‘just and reasonable’ apportionment? (Lecture P877 – 15.28 minutes)

There was an intriguing Upper Tribunal decision on the apportionment of sale consideration on a ‘just and reasonable’ basis earlier this autumn. The case is called *Oates v HMRC (2014)* and deals with the disposal of a house near Barnsley, together with some adjoining commercial land and buildings. The whole property was sold for development in June 2006 and the proceeds received by Mr Oates and his mother were £725,000.

The reason why the case arose was because Mr Oates and HMRC could not agree on the apportionment of part of the £725,000 to the main house, given that the gain on the house was exempt from CGT under the principal private residence relief rules.

HMRC split the sale consideration as follows:

	£
House	170,000
Land and buildings	555,000

Mr Oates, on the other hand, submitted that the correct apportionment should be £325,000 for the house and £400,000 for the land and buildings.

The evidence for the appeal presented by Mr Oates was said by one commentator to have been 'barely adequate, with no representation or presence at the Tribunal and very little evidence or calculations in support'. HMRC, however, presented a very thorough case, coupled with substantial evidence. In the end, the Upper Tribunal found in favour of the appellant (Mr Oates) and accepted his apportionment (see (b) above). The judge did not agree with the HMRC expert witness' valuation (which was less favourable to Mr Oates) nor did he agree with the formula set out in the Valuation Office Agency Manual for dealing with values where the sum of the parts is less than the value of the overall whole. The difference between the value of the overall whole and the aggregate sum of the parts is often referred to as the 'marriage value'. In this regard, the judge made the following comment about the appropriate criteria to be used:

'In a conventional marriage value calculation, the concept that each party cannot realise their share in the development value of their combined interests without co-operating is normally reflected in the marriage value being split equally between the parties.'

The judge accepted that the value of the house in isolation was £170,000, but he did not agree that the value of the remaining land and buildings was £725,000 – £170,000 = £555,000. This put the entire marriage value into the second part. On the assumption that what the judge called the 'existing use value' of the remaining land and buildings was £245,000 (which he felt was realistic), this meant that the marriage value was £725,000 – £170,000 – £245,000 = £310,000.

Split on a 50 : 50 basis, this produced the following values for the component parts:

House – £170,000 + £155,000	=	£325,000
Land and buildings – £245,000 + £155,000	=	£400,000

Interestingly, there seems to have been no reference in this case to the principle enunciated in *EV Booth (Holdings) Ltd v Buckwell (1980)* where it was held that the two parties to a contract cannot seek to alter an agreed apportionment simply in order to mitigate a capital gains liability. In other words, the 1980 case is clear authority for the proposition that an apportionment to which two parties have agreed in a contract cannot normally be disturbed. And, in the *Oates* case, Mr Oates and the developer had agreed a split of £325,000 for the house and £400,000 for the remaining land and buildings.

Para CG14773 of the Capital Gains Manual states:

‘Our current thinking is that we are only justified in using our powers under S52(4) TCGA 1992 (for a just and reasonable apportionment) where:

(i) there is no apportionment provided; or

(ii) although there is an apportionment provided, this is unreasonable on the facts of the case.’

Why, then, did HMRC challenge Mr Oates in connection with his disposal?

Contributed by Robert Jamieson

Goodwill on incorporation (Lecture B876 – 16.12 minutes)

It is known that, for some time, HMRC have been contemplating the position where a professional person incorporates his or her business. The initial HMRC opinion was that a company could not carry on a profession so that it was just not possible to transfer a professional activity to a company. Furthermore, they argued that any such goodwill always resided in the individual concerned (i.e. it was what is sometimes called ‘personal goodwill’), in which case it could not be taken over by a company for that reason as well.

A tax expert has recently commented:

‘This resulted in one interesting letter from HMRC in which they expressed the firm view that corporation tax cannot apply to profits from a profession, with the (rather unlikely) result that the company’s profits would presumably be tax-free – a view which . . . was doubtless a surprise to the Law Society, the ICAEW, the RIBA, the RICS and others.’

However, HMRC have concluded their review and they now appear to accept that a professional activity can indeed be transferred to a company – as can the related goodwill.

It is perhaps a coincidence that this change of opinion by HMRC arises at precisely the time when they have decided to remove entitlement to entrepreneurs’ relief in connection with transfers of goodwill from any unincorporated business to a related close company and to eliminate corporation tax deductions for goodwill amortisation in the hands of the company, but only where the transfer takes place on or after 3 December 2014 – see the draft legislation which was published at the time of the latest Autumn Statement.

The tax planning which was possible before the Autumn Statement can be best illustrated by an example.

Illustration 1

Rory has operated successfully as a sole trader since 2007. His business has grown substantially and is currently making annual profits in the order of £300,000. Rory has been advised to incorporate in order to enjoy the benefit of retaining his profits at a cost of only 20%.

The incorporation of Rory’s business involves the transfer of goodwill (professionally valued at £480,000) to his new company.

Rory decided to sell the goodwill to the company for full value on 1 December 2014. He claims entrepreneurs’ relief. This produces a chargeable gain as follows:

	£
Gain (assume that market value = gain)	480,000
Less: Annual CGT exemption	11,000
	£469,000
CGT @ 10%	£46,900

This represents an effective tax rate of 9.77%. £480,000 will be credited to Rory’s loan account which will be repaid by the company – tax-free – over the next few years instead of the company paying Rory a salary or dividends, either of which would be taxable at much higher rates. Alternatively, before drawing down his loan account, the payment of a salary of, say, £5,750 (to avoid both income tax and NICs) and dividends to utilise his basic rate band would be even more tax-efficient.

If Rory had instead made the transfer on 1 January 2015 (so that an entrepreneurs' relief claim was no longer competent), his effective tax rate would be 27.36% which might still be attractive.

Whatever the motivation for the Chancellor’s recent decision, the position is now clear and the two key issues going forward will be:

(i) whether there has been a valid transfer of the business to the company; and

(ii) whether the goodwill has been correctly valued.

It is reasonable to expect that HMRC will remain vigilant about the possibility of goodwill being transferred at an overvalue. As long ago as April 2005, HMRC published a detailed statement explaining that, where the amount paid for goodwill is excessive, the excess value will be treated either as a distribution or as earnings, although there would always be the possibility of remedial action (such as a repayment to the company of the overvalue element) by the taxpayer. This was set out in Tax Bulletin 76.

Finally, for transfers made on or after 3 December 2014, a company is no longer able to claim amortisation relief for internally-generated goodwill when a sole trader or partnership incorporates. Companies currently entitled to claim such relief will *not* be affected.

Contributed by Robert Jamieson

Is it a qualifying corporate bond (QCB)? (Lecture P872 – 16.54 minutes)

The very recent decision in Trigg v HMRC (2014) was concerned with a currency conversion clause in the terms and conditions of certain bonds which were disposed of in 2009/10. In short, did the presence of such a clause prevent the bonds from being QCBs? If the bonds were QCBs (as the taxpayer argued), any gain was exempt from CGT (S115 TCGA 1992). If they were not, the gains were chargeable.

The facts

The facts were not in dispute. A partnership called Tonnant LLP was established in 2006 to exploit what was seen as an undervaluation of certain bonds by the market. The partnership acquired a number of these bonds on the secondary market at what it considered to be an undervalue, with a view to holding them to maturity or alternatively selling them off at a profit.

Six bonds were disposed of in the relevant tax year. All were issued, denominated and redeemed in sterling. Interest was payable in sterling. The terms and conditions relating to the bonds identified risk factors associated with their purchase – one such factor was that the UK might adopt the euro before the redemption date of the bond in question. This is of particular interest because many taxpayers will have assumed that such provisions in debt instruments would ensure that they were not QCBs. Other types of currency conversion clause have often been used to this effect, especially where such instruments have been issued in exchange for shares on a company sale. One of the reasons for this practice was that, during the taper relief era, it was possible to 'stretch' a taxpayer's holding period when shares were replaced by non-QCBs on a sale so that the individual could enjoy a more substantial taper relief deduction. This did not happen when the bond was a QCB. When entrepreneurs' relief took over from business asset taper in April 2008, the technique became less relevant – nowadays it does not make much difference, from a CGT perspective, whether the bond which replaces the shares is or is not a QCB. The most important point in 2014 is that a gain on a QCB is tax-free in the same way as it is for gilt-edged securities, whereas a profit on the disposal of a non-QCB is taxable like a gain on shares.

The legislation

In order for a debt instrument to be treated as a QCB:

- it must be a debt which represents a 'normal commercial loan' (S162 CTA 2010);
- it must be expressed in sterling; and
- there must be no provision for the debt to be converted into, or redeemed in, a currency other than sterling (S117 TCGA 1992).

In this case, the bonds in question contained two types of provision, but, broadly, both required the bonds to be redenominated into euros at the appropriate conversion rate if and when the UK adopted the euro.

The arguments

Before the First-Tier Tribunal, HMRC argued that both currency conversion clauses were of a type which meant that the debts could not be QCBs. Therefore, they were non-QCBs and the resulting gains were chargeable.

Intriguingly, the Tribunal disagreed with this assertion and sided with the taxpayer, holding that all six bonds met the QCB criteria. The taxpayer's first argument to the effect that the word 'sterling' means the 'currency of the UK from time to time' was dismissed by the Tribunal, given that, following conversion to the euro, the term would also refer to the currency of the other members of the monetary union. However, the Tribunal judge accepted the second contention that the phrase 'currency other than sterling' could not apply to the euro after monetary union in view of the fact that sterling would cease to exist as a consequence of such a change. As she said:

'(The words) "currency other than sterling" necessarily imported the requirement that sterling continued to exist as a separate currency to the currency to which the bonds were converted.'

And, clearly, this would not be the case. In other words, this was an argument about semantics.

Conclusion

Holders of debt instruments may wish to review their terms and conditions in the light of this decision, since what many imagined might have originally been a non-QCB security may turn out to be a QCB.

Contributed by Robert Jamieson

Deferred entrepreneurs' relief on invested gains (Lecture B878 – 14.17 minutes)

It will be recalled that the mechanism for calculating entrepreneurs' relief was amended in 2010. As a result of the changes in F(No2)A 2010, it was no longer possible for an individual to claim entrepreneurs' relief on a business gain and also to defer the accrual of that gain where the sale proceeds were reinvested in EIS shares. It was one thing or the other, i.e. the taxpayer could either claim entrepreneurs' relief in connection with his disposal but he could not then obtain relief under Sch 5B TCGA 1992 when he made his EIS investment or alternatively he could eschew an entrepreneurs' relief claim, in which case a deferral claim under Sch 5B TCGA 1992 was competent.

Nor could entrepreneurs' relief be claimed when the gain was eventually treated as accruing (usually when the EIS shares were sold).

When Social Investment Tax Relief (SITR) was introduced in FA 2014, the same constraints applied. In the words of HM Treasury:

'This has tended to deter investment in EIS shares or in social enterprises in some circumstances.'

Accordingly, the Chancellor has decided to allow potential EIS and SITR investors to benefit both from the deferral of gains and from entrepreneurs' relief on those same gains in the hope that this measure will encourage more investment in businesses via the EIS and SITR.

The recent Finance Bill includes new Ss169U and 169V TCGA 1992 to deal with these changes. S169U TCGA 1992 specifies a number of requirements which must be met in order for a gain, which has been deferred under the EIS or SITR legislation, to qualify for entrepreneurs' relief when it is finally treated as accruing. When all these conditions have been satisfied, S169V TCGA 1992 applies to govern the way in which entrepreneurs' relief is to be given. The four conditions in S169U TCGA 1992 are as follows:

1. A gain representing all or part of a gain which has previously been held over under the EIS or SITR legislation must be treated as accruing (S169U(2) TCGA 1992). This gain is known for the purposes of these rules as 'the first eventual gain'.

2. The disposal which originally gave rise to the first eventual gain must have been a 'relevant business disposal' (S169U(4) TCGA 1992), ie. a material disposal of business assets or an associated disposal – see S169H(2) TCGA 1992.

3. A timely entrepreneurs' relief claim must have been made in respect of the first eventual gain (S169U(5) TCGA 1992).

4. The first eventual gain must be the first gain which is treated as accruing in respect of a particular held over gain (S169U(6) TCGA 1992). This means that, where part of a deferred gain had previously accrued without an entrepreneurs' relief claim being made, it is not possible to claim entrepreneurs' relief under these new provisions when another part of the same gain comes into charge.

S169V(2) TCGA 1992 treats the first eventual gain as an amount computed under S169N TCGA 1992 and therefore as a gain on which entrepreneurs' relief is due, subject only to all or part of the £10,000,000 lifetime limit being available.

If the first eventual gain does not represent the entirety of the held over gain, the rest of the gain (when it is finally treated as accruing) is deemed to be a qualifying business disposal without the need for a further entrepreneurs' relief claim (S169V(3) TCGA 1992).

If the source of the first eventual gain was an associated disposal, the first eventual gain is also deemed to be an associated disposal and will be governed by the rules in S169P TCGA 1992 (S169V(4) TCGA 1992).

This new regime applies to business gains which, but for the deferral, would originally have accrued on or after 3 December 2014.

Contributed by Robert Jamieson

CGT pooling – Practical issues to catch out the unwary (Lecture P879 – 11.54 minutes)

This article expands on the basic CGT rules for quoted shares by looking at further practical issues that can cause problems in real life, such as holdings held at different stockbrokers and situations where a couple each own shares in the same company.

Split holdings

Some clients will use more than one stockbroker to hold investments. Care needs to be taken here, as any statement a stockbroker produces, quite likely showing a gain or loss on a sale, will only reflect the shares in that firm's nominee account, not those held elsewhere. The real tax position may be different to that shown.

Example: Micky.

Micky, a higher rate taxpayer, is a client of yours who rarely makes disposals of investments. He tells you that this year (2014/15) he has sold a substantial holding in Channon plc. The statement from his broker, Quick, Profett and Runne, shows that he has sold his whole holding of 6,000 shares for £30,000 and that they had been acquired for £20,000 in July 2004.

You tell him that there is no need to file the CGT pages of the return, as

- The gains are covered by annual exemption (£11,000); **and**
- His total disposal proceeds don't exceed 4 x the exemption (£44,000).

Perhaps encouraged by the simplicity of this, the next year he tells you that he has sold his other shares in Channon plc! He gives you a statement from another broker, Bang and Buck, showing the full disposal for £18,000 of a holding of 4,000 shares that had been acquired for £8,000 in July 1999. He is very surprised (and unhappy) when you tell him (having checked that he has no other shares in Channon plc and hasn't sold any in the past) that this means that last year's tax return is wrong, as you had not taken account of this second holding.

When he made the first sale, it was in fact out of a total pooled holding of 10,000 shares, which had been acquired for a total of £28,000. This represents a weighted average cost of £2.80/share. The gain calculation for the first disposal is therefore £30,000 – (6,000 @ £2.80) = £13,200, leaving a taxable gain of £2,200 and CGT @ 28% = £**616**. Clearly, the CGT pages of the return should have been completed for 2014/15.

Joint holdings

Be careful also when dealing with a couple who have a holding in joint names, as well as their own individual investments (a situation that is very common).

The disposal of jointly owned assets will normally be split 50:50 for tax purposes, but again a stockbroker's statement won't reflect any individual holding in the company that either or both of the couple may have and which, in a similar way to the Micky example, may affect the gain or loss arising.

The following example shows another situation where an unexpected tax liability may arise.

Example: Mr and Mrs Davis

Stephanie and Kevin Davis had been married for many years. Kevin died recently, owning 2,000 shares in Ronnie plc, valued for probate at £15 each. He had bought them for 50p each many years ago. After obtaining probate, the executors have appointed the shares to his widow.

Having been told by an accountant friend that death transfers are exempt from CGT, she shortly afterwards sells the shares she inherited for £14.90 each in the market. When her accountant is subsequently preparing her tax return, he asks if she owns any other shares. She replies, "Just the Ronnie ones that I bought around the same time as my husband bought his, but I'm keeping those for a few more years yet". On checking further, the accountant confirms that she in fact bought 3,000 of the shares @ 42p each a couple of months after her husband had bought his.

The CGT position is that the shares inherited from her husband are deemed to have been acquired by her at his date of death for their probate value of £15 each. In the days of taper relief, the subsequent sale would have been matched against this cost, as holdings were matched individually on a LIFO basis. This would have resulted in a small capital loss of 10p/share.

However, under the current regime, the inherited shares are added to her existing holding of Ronnie shares in the s.104 pool. This produces a total holding for her before the disposal of 5,000 shares, with cost of £31,260 ((2,000 @ £15) + (3,000 @ 42p)). This gives a weighted average cost of £6.252.

The disposal of the inherited shares therefore produces a gain of £17,296 (2,000 x (14.90 – 6.252)), rather than a small loss! Assuming she has the full annual exemption available, this will mean a taxable gain of £6,296. The CGT on this will depend on her income tax position, but could be as much as £1,763 if it is all taxed at 28%.

If the executors of Kevin's estate had been aware that she intended to cash in the shares but also held some herself, it would have been much more sensible for them to have sold the shares themselves and then given her the cash. Kevin's shares would then never have been added to her holding and the CGT cost for the executors would have been the probate value of £15 per share. Based on a sale price of £14.90 each, the executors would have made a small loss of £200 rather than a significant capital gain.

Further complications

Rights issues

Where shares have been acquired under a rights issue, they are deemed by s.126 (2)(a) to have been acquired on the date that the original shares were acquired. Historically, this could make CGT calculations relatively complicated (in the days of indexation allowance or taper relief), so particular care should be taken if dealing with a disposal of shares where previously there have been both acquisitions under a rights issue and disposals under the pre-FA 2008 matching rules.

Scrip issues and scrip dividends

Scrip ('bonus') issues are free issues of shares to existing shareholders on a pro rata basis to their existing holdings. They therefore do not raise any finance for the company. When undertaken by quoted companies, they have the effect of putting more shares on the market, with a consequent dilution of the share price. As with rights issues, bonus shares are treated as having been acquired on the same date or dates as the original shares.

When dividends are taken in the form of shares ('scrip dividends') rather than cash, different rules apply. Normally, the value of the shares is taken as the cash dividend forgone. However, under s.412 Income Tax (Trading and Other Income) Act 2005, if the market value of the new shares on the first date of dealing on the London Stock Exchange differs by 15% (up or down) from the amount of the cash dividend forgone, the market value of the shares is used. This then becomes the CGT cost of these shares.

Conclusion

Most practitioners will feel that they can just rely on their tax software to do all the calculations for them, but it is important to make sure your client gives you full and correct information (and that you then input it correctly). As the examples have shown, it is worth double checking with the client that he or she hasn't forgotten about disposals in earlier years, or about holdings with other stockbrokers.

It's also worth factoring in compliance time where clients do a lot of trading.

Of course, there are lots of other issues that can impact on CGT calculations for listed shares, including dividend reinvestment plans (DRIPs), sale of rights, takeovers involving shares, bonds or convertibles as part of the consideration, inter-spousal transfers and employee share schemes (of various forms). Don't underestimate how many complications there can be in what, at face value, are now relatively straightforward matching rules.

Contributed by Kevin Read

SDLT planning and s 75A

Summary - The UT found that FA 2003 s 75A applied to a transaction which would otherwise have been exempt from SDLT.

The issue was the SDLT payable on the disposal of the Chelsea Barracks by the Secretary of State for Defence (SSD) for a price of £959m.

The sale comprised the following steps:

- SSD contracted to sell the land to Project Blue (PBL) for £959m;
- PBL contracted to sell the land to a Qatari bank (MAR) for $2,467,875,000 (sterling equivalent is £959m). An element of the price was the additional payment tranche payable on the rental payment dates under a leaseback of the land by MAR to PBL. Instalments of this tranche were to be drawn down to enable PBL to pay MAR rent due under the leaseback, so that MAR was paying to PBL an instalment of the price of the freehold and PBL would then pay that sum to MAR as rent under the leaseback; and
- PBL and MAR granted each other put and call options over the land.

Decision:

The UT observed that the transaction could either be seen as a sale followed by a sub-sale and a leaseback, or as a transaction financed by MAR in compliance with Sharia law. In particular, it was established that Sharia law would not have permitted MAR to fund PBL's purchase on terms which involved a loan by MAR to PBL, together with interest payable to MAR. Payments of rent under the leaseback were therefore the economic equivalent of payments of interest under a loan.

Under FA 2003 s 45 (before its 2008 amendments), PBL was not liable to SDLT as the completion of the contract between SSD and PBL was 'disregarded' under 'sub-sale relief '.

Under FA 2003 s 71A, no SDLT was payable on the transfer from SSD to MAR under the second contract. This was because s 71A ensures that no SDLT is triggered by Sharia compliant financing. Consequently, both the transfer to MAR and the leaseback by MAR were exempt alternative finance transactions.

The UT therefore had to decide whether FA 2003 s 75A applied to the transaction so that SDLT was payable. The UT first robustly rejected the contention that s 75A can only apply where a tax avoidance purpose is established. Section 75A applies to a series of transactions between a vendor 'V' and a purchaser 'P', where the total SDLT payable is less than would have payable on a direct sale by V to P. Agreeing with the parties, the UT found that SSD must be V — although it found no compelling reason to do so in s 75A. As to the identification of P, the UT stressed that it was not necessarily the party avoiding tax, or the last or first person in the scheme to qualify. The UT found that PBL was P so that SDLT was due on £959m.

Comments - The case turns on the eponymous SDLT 'mini GAAR': FA 2003 s 75A. In navigating the rocky waters of its application, the case provides some useful guidance. In particular, it confirms that s 75A applies in a mandatory way; it does not confer HMRC any discretion.

That said, the identification of 'P' remains challenging, so much so that the judges disagreed and a casting vote had to be used.

Project Blue v HMRC [2014] UKUT 564

Inaccuracy in an IHT return

Summary - FTT found that a penalty for deliberate inaccuracy in an IHT return had been rightly imposed.

The deceased had a bank account in Switzerland. In March 2009, he instructed his Swiss bank to transfer £443,669 to his son Clayton Hutchings, who was also the residual beneficiary of the estate. This was a potentially exempt transfer (PET), subject to IHT if the donor dies within seven years of the transfer (IHTA 1984 s 3A). The donor died seven months later.

When the executors submitted the inheritance tax return, it made no mention of the transfer to Mr Hutchings. In July 2011, HMRC received anonymous information about the offshore bank account, leading to the assessment of Mr Hutchings. HMRC also informed Mr Hutchings that he would be imposed a 35% penalty by reference to the increased IHT due by Mr Hutchings and the estate (as a result of the loss of part of the nil rate band). Mr Hutchings was appealing against the penalty.

Decision:

The FTT noted that HMRC was alleging a subjective state of mind; that Mr Hutchings had deliberately withheld information — this was very close to an accusation of dishonesty — and so the burden of proof was on HMRC, on a balance of probabilities. HMRC had satisfied this burden.

The FTT found that Mr Hutchings had given inconsistent and incompatible explanations for his failure to disclose the account. He had lied on several occasions, in particular when claiming to have forgotten the account — he had travelled to Switzerland to effect the transfer. The FTT concluded that Mr Hutchings had been hiding the money from HMRC.

Under IHTA 1984 s 216, as the beneficiary of a PET liable to pay the tax, Mr Hutchings had a duty to disclose his liability. He was therefore liable to a penalty (FA 2007 Sch 24).

Finally, the disclosure by Mr Hutchings had clearly been prompted (it was the result of a challenge by HMRC) and so the maximum reduction to the penalty was 50%.

Comments - HMRC had found out about the offshore bank account because of an anonymous disclosure. However this was not enough to establish 'deliberate default'. Contrary to situations where the taxpayer has the burden of proving that an assessment is wrong (as he possesses all the evidence), HMRC was alleging a subjective intention akin to dishonesty and so the burden of proof lied with them.

Timothy Clayton Hutchings v HMRC [2015] UKFTT 0009

Administration

Surcharges stand

Summary – The FTT found that the taxpayer did not have a reasonable excuse

The taxpayer was late paying income tax for 2008/09, 2009/10 and 2010/11. HMRC imposed surcharges for the delayed payment. The taxpayer appealed, saying he had sustained injuries in a serious car accident in February 2009. These, he claimed, had a "catastrophic" impact on his finances because he was unable to work normally and had to pay for medical treatment and legal expenses.

HMRC accepted that initially the accident had affected the taxpayer's ability to work, but it was clear that he had since regained the ability to work and organise his life.

Decision:

The First-tier Tribunal agreed that the taxpayer's income was much less than before the accident but said this did not amount to a reasonable excuse because the tax due was calculated as a proportion of that reduced income. Further, the late payments occurred two years after the accident, by which time the taxpayer had returned to work. This indicated also that he should be able to organise himself to pay the tax due on time.

The taxpayer's appeal was dismissed.

Comments – The comments by the FTT that the taxpayer's income was much less than before the accident but said this did not amount to a reasonable excuse because the tax due was calculated as a proportion of that reduced income. Additionally the late payments were much later. There is a limit to how long facts can support a reasonable excuse.

K Olsen v HMRC TC4167

Not for registrar to decide

Summary – The case was dismissed as the bankruptcy registrar did not have jurisdiction

The taxpayer, Emma Hope, was a shoe designer, who initially operated as a sole trader but transferred the business to a company in November 2007. In December, HMRC raised a VAT assessment for £120,725.

In April 2009, the company went into liquidation and the taxpayer proposed an individual voluntary arrangement (IVA) at a creditors' meeting. The proposal was rejected and HMRC's claims were admitted in full. Ms Hope appealed to the bankruptcy registrar against the decision to reject the IVA and, during the hearing, claimed the VAT assessment was incorrect. The assessment was withdrawn but the argument continued. The registrar dismissed the taxpayer's appeal, saying the assessment had created a statutory debt, which was due at the creditors' meeting, and the chairman had been right to admit it.

The taxpayer appealed. She argued that the assessment had not been made to HMRC's best judgment; it contained errors so serious that it should be set aside. She also claimed the registrar had been wrong to say that the sums due in the assessment were valid after it had been withdrawn.

Decision:

John Male QC sitting as deputy judge of the High Court said the issue of best judgment had not been raised before the registrar. However, even if it had, the issue could be decided only by a tax tribunal. The registrar had been correct to find that the assessment created a statutory debt.

The taxpayer's appeal was dismissed.

Comments – Appeals need to be brought before the appropriate decision maker and were not in this case.

Hope v Ireland and others, Chancery Division

Not fit and proper

Summary – The FTT found that previous conduct was still relevant and the taxpayer was not a fit and proper person.

In February 2013, Serviced Office Company Ltd applied to register as a trust or service company under the Money Laundering Regulations 2007.

As the sole shareholder of the company, H applied for a fit and proper test. HMRC told H that he failed the test because, in 1993, he was guilty and jailed for conspiracy to defraud, and disqualified from being a company director for ten years. Based on this information, HMRC believed he represented a higher risk of money laundering.

As a result, H passed his shares in the company to his wife who passed the fit and proper test, and the company was registered under the regulations.

However, with a view to being able to transfer the shares into his name, H requested a review of HMRC's decision on the basis that his conviction was more than 20 years ago. He said:

"The mission of the HM Prison Service is to rehabilitate prisoners and release them as law abiding citizens. I consider that I have satisfied the authorities in their philosophy and feel that it is very unfair to put such an obstacle in the way of my company, which is completely law abiding."

HMRC confirmed their decision, saying H had seemed dismissive of his offence, the crime had been serious involving £55m in lost corporation tax and £30m in interest, and the Serviced Office Company provided virtual services offering anonymity that would be attractive to criminals. H appealed.

Decision:

The First-tier Tribunal said that H was found to have been a leading figure in the fraud, and had done nothing to report or prevent it. So there would have to be "cogent and compelling evidence of rehabilitation" to justify regarding the conviction as not being sufficient in itself to result in H failing the fit and proper test.

It seemed H had been involved financially with another company recently but had "played little part in monitoring how the company was being managed" and had been "too trusting of management".

Further, he showed no repentance for the 1993 conspiracy. He had pleaded not guilty, as was his right, but downplayed his role, saying it was a corporate matter.

The tribunal concluded he had not been rehabilitated sufficiently to allow him to pass the fit and proper test.

The appeal was dismissed.

Comments – This case is a good illustration of the importance of convictions particularly where they relate to the integrity and honesty of the taxpayer. It should serve as a lesson to all taxpayers.

M Hunt v HMRC TC4183

Witness expenses

Summary - The First-tier Tribunal directed that a witness summons be issued in Abbey Forwarding (in liquidation) (TC4101).

The application had been made by Abbey for the summons to be issued to Louise Brittain, a former liquidator of the company.

The issue arose as to the amount of expenses that should be paid to the witness.

Decision:

The tribunal judge said such a payment should not be confined to out-of-pocket expenses. On the other hand, it should relate only to the witness herself, and not encompass any loss to the witness's employer or business partners. Therefore, it was not appropriate to calculate the expenses in line with the witness's charging rates.

On this basis, the judge said the witness should be paid in accordance with the Guide to Allowances under part V of the Costs in Criminal Cases (General) Regulations 1986.The maximum amount payable to a professional witness was set out in appendix 1 to the guide under the heading "regulation 19" (£174). In addition, she should be allowed travelling expenses of £100.

Comments - The tribunal judge said such a payment should not be confined to out-of-pocket expenses. On the other hand, it should relate only to the witness herself, and not encompass any loss to the witness's employer or business partners. Therefore, it was not appropriate to calculate the expenses in line with the witness's charging rates

Abbey Forwarding Ltd (in liquidation) v HMRC TC4190

Postponement application

Summary – The taxpayer could not justify the lack of tax on large sums of money found.

After a criminal investigation by the Serious Organised Crime Agency (now the National Crime Agency) involving the taxpayer's husband, and a raid on the marital home, substantial sums of money were found in the taxpayer's wardrobes and with her possessions.

An investigation took place. This uncovered large deposits in bank accounts and found she had no employment or self-assessment record for the relevant years. This led to the agency raising assessments on her for the years 1996/97 to 2004/05. She appealed and applied to have the tax postponed.

Decision:

The First-tier Tribunal said that the taxpayer had “presented absolutely no evidence of her correct tax liability” for the years in question. Apart from 1996/97, there was nothing to show that she had been overcharged to tax and the application for the years 1997/98 to 2004/05 was refused.

Comments – The decision is self-explanatory and it is amazing in such circumstances that it went to appeal.

NS Haq v HMRC TC4192

Careless inaccuracy in a return

Summary - The FTT found that an inaccuracy in a corporation tax return was careless.

Elsina is an overseas company carrying on business in the UK through a London branch. Following an enquiry into Elsina's corporation tax return, HMRC considered that dividends which had been omitted from Elsina's taxable income were taxable. Elsina's tax accountant amended the return accordingly. HMRC sought to impose a penalty for inaccuracy under FA 2007 Sch 24.

The penalty could be imposed if the inaccuracy was careless or deliberate.

Decision:

The FTT noted that in the case of a 'substantial and sophisticated operation' like Elsina, it was appropriate to expect a degree of expertise when carrying out tax compliance tasks. Elsina's tax adviser had simply assumed that the relevant dividends fell within the general rule, whereas under CTA 2009 s 931W, they fell to be included in Elsina's taxable income. In so doing, the adviser had failed to take 'reasonable care' and Elsina could not 'hide behind' its adviser.

Finally, the penalty must be calculated by reference to the 'potential lost revenue' and Elsina contended that the lost revenue was nil. Elsina had carried forward losses. The FTT observed that it was for Elsina to show that there was no reasonable prospect of the losses being used to support a claim to reduce a tax liability. The FTT found that the limited evidence available did not enable it to establish that this was the case. The penalty was therefore due and the 95% reduction for partial disclosure was adequate. Elsina's adviser had not made a full disclosure when challenged on the 2010 return, in particular that a similar adjustment would be due in relation to the 2011 return.

Comments - The case confirms that the carelessness of a tax adviser can be attributed to its client. It also shows that the burden of proving that an inaccuracy has not resulted in a loss of tax revenue lies firmly with the taxpayer.

Elsina v HMRC [2015] UKFTT 0014

Legal professional privilege and search warrants

Summary - The High Court refused an application for judicial review in relation to the seizure of documents.

Mr Chaudhary is director and sole shareholder of Accident Claim Helpline Ltd (ACHL), which processes personal injury claims. It conducts investigations and refers cases to firms of solicitors. Some of its files are subject to legal professional privilege (LPP).

In September 2011, following an application by HMRC's Criminal Investigations Division, the Crown Court issued search warrants (under the Criminal Evidence Act 1984 s 15) in relation to ACHL's nine addresses. During the search, thousands of files were seized.

On 7 January 2013, Mr Chaudhary issued an application (under the Criminal Justice and Police Act 2001 s 59) for the return of the entirety of the seized items and any copies thereof. In the alternative, he sought the return of all the legally privileged material.

Decision:

The issue was whether the Crown Court had jurisdiction to determine whether the warrants were in breach of the Criminal Evidence Act 1984, as they potentially permitted the seizure of unlimited material. The High Court stated that judicial review is the only route to challenge a warrant (*Goode* [2013] EWHC 1726).

It noted that most of the documents had been returned, HMRC having only retained evidence of undeclared income. It added that the fact that some documents which should have been left behind had been seized did not render the warrant unlawful (*Bramley* [2000] QB 576). There was no basis for granting a judicial review remedy.

Comments - The case confirms that the fact that legally privileged documents have been seized during a search does not invalidate the warrant or entitle the claimant to judicial review.

R (on the application of Chaudhary) v Bristol Crown Court and HMRC [2014] EWHC 4096

Tax penalties and the Bill of Rights

Summary - The FTT found that the taxpayer could not rely on the Bill of Rights to refuse to sign his tax return.

Mr Pendle appealed against a penalty for late filing. Although he had sent his return on time, he had not signed the declaration in box 22.

When HMRC had sent the return back to him, Mr Pendle had cited the Bill of Rights and explained that signing the declaration would be 'signing away his constitutional rights'. He had eventually signed the return 'wholly under duress and under the threat of extra fines'.

Decision:

The FTT noted that TMA 1970 s 8 prescribes the contents of a return, namely the information reasonably required to establish a person's taxable income and capital gains. There is therefore no statutory obligation for the taxpayer to sign a declaration that he understands that 'he may have to pay financial penalties and face prosecution if he gives false information'. However, the declaration that the information contained in the return is correct and complete is required by s 8 and Mr Pendle had not signed that declaration by the due date. The return he had filed by the due date was therefore incomplete.

Relying on the Bill of Rights, Mr Pendle also argued that penalties could not be issued without a conviction. Applying *Jussila v Finland* [2009] STC 29, the FTT confirmed that the penalty could be criminal in nature. However, referring to *R (oao McCann) v Kensington & Chelsea* [2002] UKHL 39, the FTT found that, as the penalties do not 'culminate in the conviction and condemnation' of the taxpayer and simply require the payment of a fine, they were not criminal under UK law.

In any event, the FTT noted that the application of the Bill of Rights was not limited to criminal penalties, as 'civil penalties did not exist in 1689'. The Bill of Rights could therefore have applied, were it not for the fact that it only banned the imposition of fines without appeal. The FTT added that, in any event, the conclusion that the Bill of Rights had been amended by subsequent legislation was 'irresistible'.

The FTT concluded that although Mr Pendle's belief that he could rely on the Bill of Rights had been genuine, it had not been reasonable and so he had not had a reasonable excuse for not signing the declaration.

Comments - Many taxpayers have attempted to rely on ECHR, but this challenge based on the Bill of Rights was rather unique. The key finding of the FTT is that the Bill of Rights, whether or not relevant, has been amended by subsequent legislation and, in particular, tax legislation.

Wayne Pendle v HMRC [2015] UKFTT 0027

Lack of care

Summary – The taxpayers' appeal against penalties was dismissed through lack of effort.

A couple traded in partnership offering electrical services to domestic, commercial and industrial customers. After an enquiry into the partnership's return for the year to 30 April 2004, HMRC found excessive travelling and subsistence claims.

Further investigation led to the department to believe that expenses had been over-claimed in the years 2001/02 to 2007/08. It amended the partnership profits for each year and for the inaccuracies imposed penalties at 35% of the outstanding tax under TMA 1970, s 95.

The partnership appealed, saying the adjustments were, in effect, guesses on the part of HMRC and the penalties were excessive.

The partners claimed that they had both suffered "life-threatening illnesses", they had co-operated with HMRC's enquiry, and they had relied on their accountant.

Decision:

The First-tier Tribunal said it was "clear" that the partners had not taken sufficient care in preparing the partnership accounts and returns. It was for the taxpayer to show that HMRC's figures were incorrect, but no evidence was produced.

The tribunal judge therefore confirmed the Revenue's figures.

On the penalties, the tribunal said they were in line with the legislation and proportionate to the inaccuracies. No special circumstances would justify a reduction.

The taxpayer's appeal was dismissed.

Comments – Taxpayers who do not take the process for tax returns or appeals seriously cannot expect the appeal process to work in their favour. The judge's comments are self-explanatory

KLS Electrical Contracting v HMRC TC4216

HMRC puts forward new measures to tackle persistent tax avoiders

HM Revenue and Customs (HMRC) has published the consultation paper, 'Strengthening Sanctions for Tax Avoidance', setting out proposals to tackle the serial use of tax avoidance schemes on 30 January

Tax avoiders can already face penalties, but this consultation proposes additional financial costs such as a surcharge and additional reporting requirements on users of multiple schemes that fail.

Serial avoiders use multiple tax avoidance schemes at the same time – whether using the same avoidance scheme in more than one year, or using different avoidance schemes – to avoid significant amounts of tax.

The consultation also considers whether, and how, to introduce additional penalties for cases where the General Anti-Abuse Rule (GAAR) applies. The GAAR counters the most abusive avoidance.

The Financial Secretary to the Treasury, David Gauke, said:

The government introduced the Accelerated Payments regime last year to fundamentally reduce the incentive to engage in tax avoidance.

HMRC has already issued notices worth over £1 billion, requiring avoidance scheme users to pay their tax upfront, like the vast majority of taxpayers.

Today, we are proposing further action, such as penalties, to tackle the small hard-core group of people who repeatedly use avoidance schemes.

Our message is clear: it is time to get out of avoidance and start paying your fair share.

The consultation follows the announcement by the Chancellor last December that the government would consult on potential sanctions for repeat users of known avoidance schemes.

As part of the ongoing clampdown on tax avoidance, HMRC has set up the new Serial Avoiders Unit (SAU) which will identify and tackle users of multiple avoidance schemes.

The specialist unit will offer a new hotline service to help people who have used multiple schemes and want to get their tax affairs in order. This will provide a single point of contact within HMRC to facilitate resolution of their tax affairs.

In addition, HMRC has also today published the top ten things that users of multiple schemes need to be aware of.

Jennie Granger, Director General, Enforcement and Compliance, HMRC, said:

HMRC is determined to clamp down on the small number of people who engage in tax avoidance.

As part of this, HMRC is increasing its focus on users of multiple schemes and increasing the level of resource and intensity devoted to tackling these avoiders. I would strongly encourage people to get in touch to settle their affairs and put the past behind them.

The consultation paper is available at https://www.gov.uk/government/consultations/strengthening-sanctions-for-tax-avoidance.

10 things serial avoiders need to be aware of:

1. HMRC is serious about stopping avoidance: the government is taking unprecedented steps to clamp down on the small minority who try to avoid paying tax that is legally due.
2. Other people are getting out of avoidance: increasing numbers of people involved in multiple avoidance schemes are approaching HMRC to settle up so that they can put the past behind them and protect their reputation.
3. HMRC want to help you to get out of avoidance: HMRC will work with avoiders who demonstrate a commitment to resolving their avoidance arrangements to finalise their tax liability and will provide certainty over payment terms. HMRC has set up a single point of contact to help establish the possible terms for exit from each scheme a serial avoider uses.
4. HMRC is moving more quickly to tackle serial avoiders: as they close in and increase their focus on this minority, HMRC will look ever more carefully at those who use multiple schemes.
5. You are the one who is responsible: even if a promoter or agent has arranged the avoidance scheme for the user, the avoider remains responsible for their own tax affairs and what is put on their tax return. Serial avoiders will personally have to provide HMRC with information and documents regarding their tax affairs.
6. HMRC has a special unit looking at you: the Serial Avoiders Unit is identifying users of multiple schemes who choose not to approach HMRCto settle their affairs.
7. You may personally have to attend meetings with HMRC investigators:HMRC will ask you about your tax affairs and will be checking that they have the full facts about your arrangements.
8. HMRC will look at all your tax affairs: serial avoiders will be subject to a more co-ordinated approach to challenge and resolve their tax affairs.HMRC will look at your current activity, not just enquiries that are already open. And they will look at all the entities and structures you are connected with, to challenge any avoidance and evasion in all areas of your affairs.
9. You may have to pay up front: HMRC will fundamentally reduce the incentive to engage in serial tax avoidance and recover all duties legally due at the earliest opportunity. Multiple users of schemes may receive Accelerated Payment Notices before other users of a scheme.
10. There are heavy sanctions: HMRC will evaluate the behaviour of each serial avoider and this could result in penalties for careless or deliberate behaviour or for any failure to disclose avoidance. Deliberately misleading or concealing information from HMRC could lead to prosecution and criminal conviction.

HMRC news

HM Revenue and Customs (HMRC) has published the consultation paper, 'Strengthening Sanctions for *Further GAAR guidance issued on 30 January 2015.* The General Anti-Abuse Rule (GAAR) tells you which tax arrangements are abusive under the legislation- further guidance

Business Taxation

Trade of horse ownership had the feel of a hobby

Summary - The FTT found that the appellant was not carrying on the trade of horse ownership.

The issue was whether Mr McMorris should be permitted to set losses incurred in a racehorse activity against other income of the same tax year. This depended on whether the losses were the result of a 'commercial trade' (ITA 2007 s 66).

Mr McMorris had purchased half a share of a racing horse. He had also agreed to meet half of the livery and racing costs. Unfortunately, after a promising debut, the horse's performance had deteriorated. Mr McMorris and the co-owner of the horse had decided to sell it, realising a substantial loss. Mr McMorris' claim for loss relief was rejected on the ground that his horse ownership had been no more than a 'hobby'.

Decision:

Referring to the badges of trade, the FTT first observed that as a one-off transaction, unrelated to Mr McMorris' other activities, the ownership of the horse seemed to have amounted to a non-trading activity.

It added that the informality and uncertainty of the arrangement had the 'feel' of a hobby, noting that Mr McMorris had clearly derived enjoyment and pride from his ownership of the horse.

The fact that he had hoped to make a profit did not change the position.

Comments - This case is the latest example of a hobby activity being denied the status of a trade. As stressed by the FTT, the fact that an activity is carried out with the hope of profit is not sufficient to establish a trade.

McMorris v HMRC TC 4204

Negligence by tax advisers

Summary - The High Court found that Altus' claim for negligence against its professional advisers must fail.

Altus claimed damages for professional negligence by Baker Tilly, for failing to give advice which would have enabled Altus to implement a restructuring proposal to mitigate its tax liabilities.

Decision:

The court pointed out that the first issue was whether the implementation of the restructuring proposal would have resulted in a tax saving, which included assessing the chance of whether the scheme would succeed or fail upon a challenge.

The court also noted that a professional would be expected to adopt any filing position that was properly arguable and was in the client's best interests, while at the same time making a full disclosure to HMRC. However, no damages were recoverable for a breach of this duty on account of public policy.

Secondly, Baker Tilly was under a duty to exercise reasonable skill and care within the terms of its retainer. This meant that it ought to have brought the prospective new CTA 2009 s 1263 to the attention of its client, as it ought to have been aware of this without engaging in 'horizon-scanning for future legislation'. This was particularly so as Baker Tilly held itself to be a 'top-end and very large firm of specialist advisers'.

Thirdly, the court found that Altus would have implemented the proposal if it had been put to the company. It would have wanted to preserve its tax position and would have looked to overcome any difficulties inherent to the proposal.

However, the court found that if Baker Tilly had been aware of the new s 1263, it would have consulted PwC (and not E&Y, the authors of the restructuring proposal).

It also found that PwC would not have come up with a similar proposal, given that it had not implemented a similar structure.

Comments - The court suggested that advisers who market themselves as experts owe a higher duty of care. However, interestingly, it also found that the fact that one firm (E&Y) had come up with a structure did not necessarily mean that a similar firm (PwC) would have come up with it**.**

Altus Group v Baker Tilly Tax [2015] EWHC 12

Qualifying trade

Summary - The FTT found that a company had not been carrying on a qualifying trade.

The issue was whether income tax relief under ICTA 1988 s 574 applied to a disposal of shares deemed to have been of 'negligible value'. This depended on whether the company was a 'qualifying trading company'. The key point was whether the company's trade was 'money lending … or other financial activities'.

This in turn depended on whether the company had entered the mortgage market in its own right or had licensed the IP rights and systems in its 'income bonded loan' concept to third party lenders. The company had never reached the stage of carrying on a trade. The issue was therefore whether the company had existed 'for the purpose of carrying on a trade'.

Decision:

The FTT found that the purpose of the company had been to establish a trade in which it would itself offer residential mortgages until the end of July 2015. During that period, it was therefore not a 'qualifying company'. After that time, the company had considered alternative ways of deriving value from its product.

The FTT found, however, that the company had had no clear purpose from July 2015 apart from making a financial recovery and so it had not carried on a qualifying trade during that time either.

Comments -The FTT's analysis of the second phase of the company's existence is of particular interest. Although the company was trying to find a way to become profitable, in the absence of a defined purpose, it was not carrying on a qualifying trade.

Ian Branagan v HMRC TC4188

Was the trade conducted on a commercial basis?

Summary - The FTT found that a social worker carrying on two unrelated loss making trades was not entitled to loss relief.

Mr Patel was a psychiatric social worker who was employed full time. In 2004, he started a trade known as Silver Spice, supplying ingredients and running cookery workshops. In 2007, he started a separate trade selling Indian art. The issue was whether he could set off losses incurred in either of those trades against his employment income. HMRC denied set off, on the ground that the trades did not satisfy either of the conditions of ITA 2007 s 64. They were not conducted either on a commercial basis or with a view to profit.

Decision:

The FTT accepted that some factors pointed to a commercial approach: the products looked professional; steps were taken to protect the Silver Spice trademark; and professionally designed websites were set up. However, Mr Patel did not seem to be concerned with the level of sales; and it was clear that he was most interested in the cookery workshops, which produced virtually no income. The FTT concluded that Mr Patel's motivation was to share his enthusiasm for cookery and spices and that he must have realised that the likelihood of generating profits was remote. The same applied in relation to his other trade.

Furthermore, the trades were not carried out with a view to profit. Mr Patel did not put any effort into the one product which was popular with customers (a marinade) and instead focused on his workshops.

Comments - This case is a typical example of a hobby activity carried out for the enjoyment of the taxpayer, which does not qualify for loss relief. The case also confirms that the issue of profitability is relevant to both s 64 conditions. A person who is not interested in profits will not act commercially.

Dipak Patel v HMRC [2015] UKFTT 0013

Purchase of own shares - Multiple completion contracts **(B877 – 22.13 minutes)**

It will be recalled that CTA 2010 spells out numerous conditions which must be satisfied in order for an own share purchase to qualify for CGT treatment in the hands of the exiting shareholder.

One of the more important is that, immediately after the purchase, the vendor must not be 'connected with' the acquiring company or with any company within the same 51% group (S1042 CTA 2010). For this purpose, 'connected with' means holding, directly or indirectly, more than 30% of the company's:

(i) issued ordinary share capital; or

(ii) total share and loan capital; or

(iii) voting power (S1062 CTA 2010).

Interests held by 'associates' (eg. a spouse or minor child) need to be included.

It should be noted that, by virtue of S1063 CTA 2010, the term 'loan capital' is given an extended meaning such that an immediate loanback, for example, of all or part of the vendor's consideration can be caught.

In addition, if the vendor still retains some shares after the own share purchase, his proportionate interest in the company must be 'substantially reduced' (S1037 CTA 2010). 'Substantial' in this context means 25% or more. It is necessary to determine the vendor's interest in the company immediately before the share repurchase and, if it comes down by 25% or more, a substantial reduction has occurred. Once again, interests held by associates must be taken into account in measuring the reduction.

A common problem

It is not uncommon for a company which is about to embark on an own share purchase to have cash flow constraints, in which case the obvious solution might be for the vendor to lend all or part of the share payment back to the company. Unfortunately, this arrangement will nearly always be caught by the 30% 'no continuing connection' test referred to above.

Alternatively, if, to begin with, the vendor sells a smaller part of his shareholding to the company, he is likely to fall into the 'substantial reduction' trap.

The solution

An increasingly useful solution to this dilemma is for the company to enter into a single unconditional sale contract with the vendor, with legal completion of the buy-back taking place on a series of dates in the future in respect of separate tranches of shares within the agreement. This is known as a multiple completion contract. The effect of this procedure is that the 'substantial reduction' test only needs to be considered once, ie. at the date of the contract. The vendor must give up his beneficial interest in the repurchased shares on entering into the contract and so he cannot subsequently take dividends or exercise voting rights (but see below) over the shares. He must also satisfy the 'no continuing connection' test. However, it should be emphasised that completion of the contract in stages does not create a debt for this purpose.

As far as CGT is concerned, the disposal of the entire beneficial interest in the shareholding takes place at the date of the contract. The vendor therefore needs to ensure that he has sufficient cash resources with which to meet the full tax liability by the 31 January following the tax year in which the multiple completion contract is made.

HMRC nowadays accept that a multiple completion contract is a valid arrangement provided, of course, that beneficial ownership passes at the contract date – see ICAEW TR745.

A fairly new difficulty is that HMRC appear to be of the opinion that company law still entitles the vendor to vote on his shares, notwithstanding that he has contracted to sell them and has lost beneficial ownership. On the assumption that this view is correct (which is by no means certain), this could make the vendor 'connected with' the company under S1062(2)(c) CTA 2010 if the voting rights on what might be called the 'non-completed' shares exceed the 30% limit. If this is likely to be a serious issue, the problem can be resolved by converting the relevant shares into a separate class of non-voting ones.

There was an excellent article on the practicalities of the multiple completion procedure in the issue of 'Taxation' dated 13 October 2011.

Contributed by Robert Jamieson

Disposal of a company and contingent liability

Summary - The Court of Session found that a representation made on the sale of a company could create a contingent liability under TCGA 1992 s 49.

Mr Morrison had been a major shareholder and the chairman and chief executive of Morrisons (MPLC). He had disposed of his shares as part of the sale of the entire share capital of MPLC to Anglian Water. The forecasts he had provided to Anglian Water turned out to be materially inaccurate and Anglian Water sued for damages for misrepresentation. Morrisons also sued Mr Morrison for breach of fiduciary duty and duty of care; this was settled with a £12m payment by Mr Morrison.

Mr Morrison claimed a £12m adjustment to the calculation of the CGT due on the disposal of his shares under TCGA 1992 s 49, on the basis that the payment of the settlement was the enforcement of a contingent liability in respect of a representation made on disposal. HMRC denied the claim, on the basis that the £12 million payment was not part of the consideration.

Decision:

The court observed that the contingent liabilities described in s 49(1)(a), (b) are capable of including liabilities which emerge after the date of the disposal, but which arise as a consequence of a state of affairs already in existence at that date. In this case, the contingent liability was to make a payment in the event that a representation made on disposal turned out to be wrong and actionable because it was made fraudulently or negligently.

The fact that the payment had been made without an acceptance of liability was beside the point. The court also noted that there was no requirement that the contingent liability should be directly related to the amount of consideration, and that the capacity in which the representation was made was irrelevant.

The court concluded that the requirements of s 49(2) were met, adding that, in reality, Mr Morrison's gain had been reduced by £12m.

Comments - The case will be remitted to the FTT to decide whether the whole or, if not, what part of the settlement payment was attributable to the representations. In any event, the case confirms that a representation made by the chief executive of a company in relation to a sale of the company also relates to the disposal of his shares.

Morrison v HMRC [2014] 113

FII group litigation: quantum and remedies

Summary - The High Court (Henderson J) handed down its decision on the quantum and related issues in the FII GLO.

This is the latest instalment of a judicial saga which started in June 2004, when Park J referred the case to the then ECJ. Since then, there have been several more references to the CJEU and two other cases — *Prudential* [2013] EWHC 3249 and *Littlewoods* [2014] EWHC 868 — also have a bearing on the final outcome.

Decision:

In his introduction to the case, Henderson J explains: 'Because of the general importance of nearly all the issues, the status of the claims as test cases in group litigation, the practical certainty of appeals whatever I decide, and the huge amounts of money at stake, I have been asked by both sides to evaluate the evidence and state my conclusions on all of the issues raised by the parties, even if a decision on them is not strictly necessary to my ultimate conclusions.' The result is an exhaustive decision which runs to some 471 paragraphs.

It covers the calculation of the unlawful Schedule D Case V tax, the calculation of the unlawful ACT and remedies.

Comments - Writing for *Tax Journal*, Simon Whitehead (Joseph Hage Aaronson) said: 'The High Court has largely found in favour of the taxpayers regarding the manner in which claims should be calculated arising from the payment of ACT and tax on DV income where claimants were in receipt of foreign dividend income' (for the article, which will be published in print shortly, see www.bit.ly/16zEKst). This decision is probably not the end of the line for the litigants. Indeed, Henderson J refers to the 'practical certainty of appeals'. That said, this detailed judgment is bound to constitute a very useful reference for the higher court.

The Test Claimants in the FII Group Litigation v HMRC [2014] EWHC 4302

Unlawful curtailment

The European Commission brought an action against the UK, claiming that FA 2007, s 107 "limitation period in old actions for mistake of law relating to direct tax" was incompatible with EU law.

Decision:

The Court of Justice of the EU said that s 107 in effect curtailed the right of taxpayers to reclaim wrongly charged tax. It was therefore "incompatible not just with the principle of effectiveness, but also with the principle of the protection of legitimate expectations of taxpayers, so far as concerns the obligation under EU law to guarantee taxpayers the right to a refund of taxes paid in breach of that law".

UK v European Commission (Case C-640/13)

Deductibility of forex losses

Summary - The CJEU's advocate general (AG Kokott) considered that the non-deductibility of forex losses on a disposal subject to the participation exemption was not a breach of the freedom of establishment.

AB, a Swedish company, held shares denominated in US dollars in a UK company. The cessation of the subsidiary's activities amounted to a sale for Swedish tax purposes, thereby triggering a forex loss. The Swedish tax authorities had indicated that the loss would not be allowable. AB contended that, following *Deutsche Shell* (C-293/06), this represented a breach of the principle of freedom of establishment.

Decision:

The AG noted that, under the participation exemption, gains and losses made on disposals of shares in 'sociétés anonymes' are not taken into account for tax purposes. It added that the principle of freedom of establishment was relevant, as AB had originally been the sole shareholder of the UK subsidiary. The fact that AB had subsequently transferred 55% of the shares to its parent company did not affect the analysis: firstly, because the prospect of a tax disadvantage might have deterred it from setting up the subsidiary; and secondly, because the principle of freedom of establishment can apply to situations where the taxpayer does not hold a majority shareholding.

The AG considered, however, that no discrimination was established, as holdings in foreign companies are not necessarily more exposed to currency risks than holdings in domestic companies. He also pointed out that the decision to invest in a foreign company would not be deterred by the fact that forex losses would not be taken into account. This is because, at the time of the decision, non-taxable forex gains were also a possibility.

Comments - It remains to be seen whether the CJEU will follow the opinion of AG Kokott. In the absence of discrimination based on nationality, the key question, as pointed out by the AG, is the effect of the provision on the decision to invest in a foreign subsidiary.
X AB v Skatteverket (C-686/13),

Carry-forward of trading losses (Lecture B879 – 11.43 minutes)

The recent First-Tier Tribunal decision of Amah v HMRC (2014) concerned the carry-forward of income tax losses under S83 ITA 2007 against future trading profits. However, the underlying principles may also have relevance to the equivalent corporation tax provisions.

The case related to a dispensing optician (A) who had previously carried on a business in Wembley as a franchisee of a national optician firm (Dolland & Aitchison). On 3 April 2009, the franchise ceased with unrelieved losses of £15,838 and, on 1 June 2009, A commenced self-employment, supplying his services as a locum to established opticians in and around the area of Maldon, Essex (which was where he lived). He sought to deduct the income tax losses of £15,838 against his profits in 2009/10 as a locum on the basis that, throughout the period in question, he was carrying on the profession of a dispensing optician.

In rejecting A's claim, the Tribunal held that the Dolland & Aitchison business which he had operated was a trade, given that the franchise agreement was overwhelmingly expressed in terms of a trade. In contrast, the business carried on by A in Essex as a locum was properly the practice of a profession. In arriving at this decision, the Tribunal also noted that:

- there was a two-month gap between the cessation of the franchise and the start of the business as a locum;
- A's customer base had changed from being patients to other opticians' businesses; and
- the business location had moved from a fixed set of premises in Wembley to A being at an unpredictable variety of locations in Essex.

Unfortunately, the Tribunal did not conclude on whether it was correct that a change from a trade to a profession would prevent a carry-forward of losses. However, when reviewing the additional facts described in (c) above, the Tribunal considered that there was 'very clearly' a cessation of one business activity and the commencement of another. HMRC's assessment, which disallowed the loss claim, was therefore confirmed.

Contributed by Robert Jamieson

VAT

Agency and exempt supplies

Summary - The FTT found that a university college was making exempt supplies of accommodation to its students.

The issue was whether the supplies of term-time accommodation by an Oxford University college to students of the college were standard rated or exempt. The college had entered into an agreement with a subsidiary, which was to supply the accommodation under a licence of the property granted by the college.

Decision:

Applying *Secret Hotels2* [2014] UKSC 16, the FTT looked for any variation of the contracts (between the college and its subsidiary, and between the subsidiary and the students) by post-contract conduct. The FTT noted that the college advertised the rooms, received payments and dealt with complaints. It also set the terms of the supply of accommodation and bore the risk of non-payment by students. The economic reality was therefore that the college made the supply.

The FTT also found that the supply of accommodation was 'closely related' to the supply of education, as students were required to comply with the accommodation agreement and must seek permission to live away. The supplies of student accommodation by the college were therefore exempt under VATA 1994 sch 9 group 6.

The FTT added that even if the supplies had been made by the subsidiary, they would have been exempt within VATA 1994 sch 9 group 1 item 2, as the supplies were not similar to hotel accommodation.

Comments - The case provides a useful example of the way the principles about agency set out by the Supreme Court in *Secret Hotels2* will be applied in practice by the tax tribunals, looking beyond any contractual 'no agency' clause.

Lady Margaret Hall v HMRC [2014] UKFTT 1092

Abusive arrangements

Summary -The FTT found that arrangements were abusive under the Halifax principle.

Mr and Mrs Hearn ran a golf club in partnership. With effect from 1 February 1998, the business of the club was split into two main activities: a licence of the land by the partnership to the company (the golf course); and the supply of services by the company to the members of the club. The result was that both activities were treated as exempt by the taxpayers.

The issue was whether the reorganisation of the business had constituted an abusive practice under the *Halifax* principle (see *Halifax PLC and others v HMCE* (C-255/02) [2006] STC 919).

Decision:

Looking at the arrangements as a whole and assessing their aim objectively, the FTT asked itself whether they were contrary to the purpose of the VAT Directive.

The FTT found that the arrangements put in place were wholly artificial and did not reflect the economic and commercial reality of the relationship between the partnership and the company. The reality was that the partnership had continued to run the golf course as its proprietor. The licence fee payable by the company was calculated at a level to ensure that the partnership received all the profit and there was no evidence of any negotiation between the company and the partnership.

The arrangements – which had clearly been entered into for tax purposes – must therefore be redefined so that the partnership would be regarded as making standard rated supplies of sports services (VATA 1994 Sch 9 Group 1 item 1(m)).

In any event, the company had not qualified as an 'eligible body' (VATA 1994 Sch 9 Group 10 item 3) and so its supplies to members were not exempt.

Comments - This case is a reminder that artificial arrangements which do not reflect the economic reality can be disregarded under the *Halifax* principle.

Peter and Jaleh Hearn t/a Hennerton Golf Club v HMRC [2014] UKFTT 1115

What is 'clothing'?

Summary -The FTT found that a baby lifting blanket qualified as 'clothing'.

The issue was whether a 'Snugglebundl' (a baby lifting blanket or baby wrap for babies up to six months of age) qualified as an article 'designed as clothing or footwear for young children' and was therefore zero rated under VATA 1994 Sch 8 Group 16 item 1.

The design of the Snugglebundl made it clear that it was designed both to move the baby easily and keep it warm and comfortably wrapped.

Decision:

The Snugglebundl was designed for young children. The only question was therefore whether it was designed as an item of clothing. This depended not so much on the item's objective characteristics, but rather on the designer's intention.

As to 'clothing', it could serve some other purpose 'without thereby ceasing to be clothing'.

However, in order to be 'clothing', an item must provide some coverage of the body. This was the case with the Snugglebundl, which was therefore a n item of 'clothing'.

Comments - The decision points out that an item of clothing can have other uses and still qualify as 'clothing' for VAT purposes.

Snugglebundl v HMRC [2014] UKFTT 1121

Curtailment of right to recover tax unlawfully paid

Summary - The CJEU confirmed that the retroactive curtailment of the right to recover tax unlawfully paid was contrary to EU law.

The European Commission sought a declaration from the CJEU that, by retroactively curtailing the right of taxpayers to recover tax levied contrary to EU law (in FA 2007 s 107), the UK had failed to comply with its obligations under EU law.

Decision:

The CJEU noted that the right to a refund of taxes levied in a member state in breach of EU law is the consequence and complement of the rights conferred on individuals by the provisions of EU law. It also noted that the principle of effectiveness requires domestic procedural rules not to render the exercise of that right excessively difficult. Under the CJEU's settled case law (*Marks & Spencer* C-62/00), the principle of effectiveness prohibits the retroactive application of a new shorter limitation period, where its application concerns actions for the recovery of domestic taxes contrary to EU law and which have already been commenced at the time the new period comes into force. Section 107 was therefore contrary to EU law, regardless of the fact that another remedy (a *Woolwich* cause of action) may be available.

The CJEU added that the principle of legitimate expectation dictates that a taxpayer who has brought an action seeking a refund is entitled to expect that his action will not be declared inadmissible as a result of a retroactive change of the law. Section 107 was therefore in breach of this principle, as well.

Finally, the fact that the provision had subsequently been amended was irrelevant.

Comments - The CJEU, referring to its own settled case law, has now reaffirmed the principle that the retroactive curtailment of the right to a refund of tax unlawfully paid is contrary to the principles of effectiveness and of the protection of legitimate expectations.

Commission v UK (C-640/13)

Fraudulent activities and the rights to a deduction/exemption

Summary -The CJEU held that national tax authorities can deny the right to a deduction or an exemption where the taxpayer has engaged in fraudulent activities.

In both cases, the taxpayers had been involved in some form of VAT fraud and had been denied the right to a deduction of, or to an exemption from, VAT as a result. They contended that this denial was contrary to EU law in circumstances where the national laws did not provide for such measures.

Decision:

The case of *Turbu.com* was held to be inadmissible, as evasion had not been established by the national court so that the question was 'hypothetical'. Therefore, the reasoning of the court focused solely on the *Italmoda* case. The CJEU first observed that preventing tax evasion is an objective of the Sixth Directive and that EU law cannot be relied on by individuals for abusive or fraudulent ends. National authorities and courts can therefore refuse the rights to a deduction or to an exemption if they are relied upon for fraudulent or abusive ends. This applies not only where tax evasion has been carried out by the taxpayer but also where he knew, or should have known, that he was participating in a transaction involving evasion of VAT (*Kittel* C-439/04).

Furthermore, these rights can be denied, even in the absence of domestic provisions providing for such denial, if fraudulent behaviour is established. Finally, the fact that the VAT evasion had been committed in a member state other than that in which the benefit of those various rights has been sought did not change the position. Indeed, 'carousel fraud' is characterised by supply chains spanning several member states.

Comments - The CJEU has now confirmed that fraudulent practices can lead to the denial not only of the right to a deduction, but also of the right to an exemption, even in circumstances where this is not provided for in domestic provisions.

Staatssecretaris van Financiën v Schoenimport 'Italmoda' Mariano Previti vof (C-131/13) and Turbu.com (C-163/13)

Duty suspended goods

Summary - The Court of Appeal found that it had no jurisdiction to grant interim relief against the deregistration of a trader in duty suspended goods.

The appeal related to the regime which permits wholesale trading in alcoholic drinks without liability for excise duty, 'duty suspended goods'. CC&C was approved as a registered trader in duty suspended goods. However, HMRC revoked its registration on the ground that CC&C had failed to exercise proper due diligence. CC&C appealed under FA 1994 s 16.

Decision:

The court noted that the FTT can only exercise its powers where the decision is one which could not reasonably have been arrived at. The FTT does not have the power to quash decisions or to suspend their application pending the outcome of an appeal. CC&C relied on the general jurisdiction of the High Court under the Senior Courts Act 1981 (s 37(1)) to grant injunctive relief 'in all cases in which it appears to the court to be just and convenient to do so'. It sought an order for 'interim re-registration'. However, since Parliament could have given the FTT the power to make suspensory orders pending the outcome of an appeal, it was not open to the court to provide for such remedies. Furthermore, the absence of such power could be explained by the fact that the right to trade in duty suspended goods is a 'privilege'.

Comments - : The court suggested, that given the potentially damaging effect of deregistration (and the absence of interim relief), traders should be given notice of HMRC's contemplated decision so that they can make representations against it.

CC&C v HMRC [2014] EWCA Civ 1653

Interaction between the BT and GMAC cases

Summary - The UT affirmed its decision of 3 August 2012 and suggested that it would consider the implications of the BT decision in the course of the hearing of an application for leave to appeal.

Since the release of the UT's 2012 decision, HMRC had appealed to the Court of Appeal in relation to the preliminary issues decided by the UT in the *BT* appeal. The Court of Appeal had held that the UT had been wrong to hold that BT's claim was not time barred in respect of supplies made between 1 October 1978 and 31 March 1989. BT had been refused permission to appeal to the Supreme Court. HMRC contended that the decision of the Court of Appeal in *BT* applied to *GMAC*, while GMAC argued that such 'read across' was not possible due to the very different facts of the two cases. This is the 'BT issue'.

Decision:

The UT indicated that it was unlikely to grant leave to appeal in relation to the windfall issue decided by it in accordance with the CJEU's decision. Similarly, the UT's decision in the *BT* case in relation to the insolvency condition and time limits (other than the BT issue) had been upheld by the Court of Appeal.

The UT therefore suggested that, on an appeal by HMRC solely on the BT issue, it may be able to consider the issue on its merits — possibly remitting the matter to the FTT for further findings of facts. If, however, HMRC appeals on other aspects of the UT's decision, it may allow the BT issue to be dealt with by the Court of Appeal at the same time as the other issues.

Comments - The UT has now reaffirmed its 2012 decision. The 'BT issue' may well be the only issue which will be the subject of a further hearing on merits.

HMRC v GMAC UK [2015] UKUT 0004

Occupancy restriction

Summary - The UT found that an occupancy restriction did not prevent the application of the 'DIY builders scheme'.

Mr Barkas had appealed against HMRC's decision to refuse his claim under the 'DIY builders scheme' (VATA 1994 s 35), in relation to works carried out on two adjacent barns to convert them into an office and a dwelling. The planning consent for a 'live/ work facility' provided that the office could only be used by the occupiers of the dwelling. HMRC therefore contended that the condition in VATA 1994 Sch 8 Group 5 note 2(c) was not satisfied.

Decision:

Applying *Shields* [2014] UKUT 0453, the UT noted that the terms of the planning permission may affect the use of the building, but that a 'live/work facility' was 'not a term of art'. The UT found that the restriction contained in the planning application restricted the use of the office, but not the separate use or disposal of the dwelling. Occupiers of the dwelling did not have to use the office (but they could do so) and the dwelling could be sold separately, although the value of the dwelling on its own may be low.

Comments - Following the recent case of *Shields* (see *Tax Journal*, 24 October 2014), this case is a useful example of circumstances where an occupancy restriction does not fall foul of the condition contained in note 2(c) (VATA 1994 Sch 8 Group 5).

HMRC v Anthony Barkas [2014] UKUT 0558

VAT: single supplies of caravans with verandas

Summary - The UT found that supplies of verandas together with caravans were zero-rated.

Colaingrove sold 'static caravans' that were zero-rated under VATA 1994 Sch 8 Group 9. The issue was whether supplies of verandas (which were bolted to the caravans and sometimes also fixed to the ground) were also zero-rated. The principal question was whether the supply of a caravan together with a veranda was a single supply. The FTT (applying *Talacre Beach Caravan Sales* (C-251/05)) had found that the veranda was not 'subordinate' to the caravan and therefore its supply was not zero-rated.

Decision:

The UT noted, however, that *Talacre* had not 'jettisoned' the *CPP* principles (drawn from the *Card Protection Plan* (C-349/96) case). These were not relevant when establishing whether a single supply had taken place, but applied when deciding whether the national legislation had limited the scope of elements of a single supply which could fall within the zero-rate.

It was accepted that, on the application of the *CPP* principles, the supply of a caravan and its veranda was a single supply. Therefore, the issue was whether, as a result, the tax treatment of the caravan should be applied to the ancillary element, the veranda. In the absence of specific provisions excluding the application of the exemption to verandas, supplies of verandas must be zero-rated.

Comments - The UT has now confirmed that the CJEU's decision in *Talacre* does not mean that the *Card Protection Plan* principles should sometimes be ignored, so that domestic law principles can apply instead. In delineating the application of *Talacre*, the UT may have brought some much needed certainty. Mike Thexton, director of Thexton Training Ltd, said: “HMRC announced after the 1999 European Court of Justice decision in *Card Protection Plan* that the issue of single or multiple supplies should be easily resolved in the future. This case shows that it continues to pose problems — the detailed analysis by the Upper Tribunal picks apart the decision of the First-tier Tribunal and demonstrates how complex the issue is. The decision clarifies the way in which such a case should be argued — until and unless the Court of Appeal disagrees with it. HMRC are currently arguing several different cases with *Colaingrove* and may continue their fight on this one.”

Colaingrove v HMRC [2015] UKUT 0002

Effect of an unlawful extension to a block

Summary - The FTT held that an unlawful extension did not make an input tax block unlawful.

PwC claimed the recovery of input tax on entertainment expenses. The issue was the validity of the input tax block on recovery of input tax incurred on goods and services used for the purpose of business entertainment (art 17(6) of the Sixth VAT Directive). The VAT (Special Provisions) Order 1988 (which came into effect on 1 August 1988) had been found unlawful in *Danfoss* (C-37/07), as it had extended the block to the entertainment of overseas customers. It was eventually replaced by the 2011 Order (on 1 May 2011) and HMRC had refunded VAT incurred on the entertainment of overseas customers in the period from 1 August 1988 to 1 May 2011.

Relying in particular on the opinion of the advocate general (AG) in *Van Laarhoven* (C-594/10), PwC claimed that the effect of the unlawful extension was that the entire block was unlawful, as it lost its vires under art 17(6). Consequently, PwC was entitled to input tax recovery on all entertainment expenses. The FTT found, however, that the CJEU had made it clear in *Ampafrance* (C-177/99) that an unlawful derogation to a block did not make the entire block unlawful.

Decision:

The FTT also found that the principle of 'strict interpretation' did not mean that unlawfully extending a block rendered the entire block unlawful. It added that PwC's interpretation would lead to 'capricious' results, as the implications of an unlawful extension would depend on whether a single block was used covering various goods and services, instead of a series of narrowly defined independent blocks.

Finally, the FTT ruled that no reference to the CJEU was required in circumstances where it was confident about the issue (ex parte *Else* [1993] QB 534).

Comments - The point raised by PwC is likely to be relevant in a wide range of situations where an extension or derogation to a block is unlawful. The case confirms that this will not render the entire block unlawful.

PwC v HMRC [2015] UKFTT 7

DIY builder scheme and planning Permission

Summary - The FTT refused to apply the DIY builder scheme.

Mr Radcliffe had obtained planning permission for the erection of various extensions and alterations and the erection of a detached garage. He had then made subsequent applications for amendments, in order to be able to build a new bungalow under the guise of extending the old one.

HMRC had rejected his claim under the DIY builder scheme on the ground that the works contravened the planning permission. Mr Radcliffe contended that although the planning application referred to 'extension works', clearly a new bungalow had been constructed, so that the DIY scheme applied. He could also apply to upgrade the application.

Decision:

The FTT found that the VAT legislation requires the construction of a new dwelling to be within the appropriate planning permission. An upgrade of the application would only be effective from its date and would therefore not cure the problem.

Comments - The taxpayer had intended to build a new dwelling under the pretence of extending an existing building. Although this may have been an efficient scheme from a planning law point of view (as planning consent for a new build would not have been granted), it was counter-effective for VAT.

James Radcliffe v HMRC [2015] UKFTT 0017

MTIC fraud and knowledge of the Taxpayer

Summary - The FTT found that the taxpayer was entitled to the recovery of input tax, despite the fact that he had been involved in transactions related to MTIC fraud.

It was established that MTIC fraud had taken place. The issue was whether the directors of Pacific Computers knew or ought to have known of the connection with fraud, as this would lead to the denial of the company's input tax recovery on the relevant transactions (*Mobilix* [2010] EWCA Civ 517). This would be established — and the onus of proof was on HMRC — if the only reason for the taxpayer to participate in the transaction was fraud.

Decision:

The FTT found that HMRC's case 'came nowhere near even satisfying a low threshold'. Actual knowledge of fraud had not been shown and the directors' reliability and credibility had been established during their cross-examination. Further, the transactions were commercial for Pacific Computers.

The FTT vehemently criticised HMRC's approach, which consisted in looking at the chain of transactions as a whole, for which tax loss was established, rather than at the taxpayer's position.

Comments - Rather unusually, this is an MTIC fraud appeal that was won by the taxpayer. The FTT questioned the 'value for money' of a three-week trial for which HMRC did not have sufficient evidence.

Pacific Computers v HMRC [2015]

VAT: supply of sporting facilities

Summary - The CJEU found that the supply of sporting facilities was not a letting of immovable property.

The Luc Varenne football club, which owns a stadium, had entered into a contract with another club which was to use the facilities of the stadium. The issue was whether the contract provided for the 'letting of immovable property', which is exempt under the Sixth Directive art 13B(b).

Decision:

The CJEU noted that the fundamental characteristic of the concept of 'letting of immovable property' for the purposes of art 13B(b) 'lies in conferring on the other party to the contract, for an agreed period and for payment, the right to occupy property as if that person were the owner and to exclude any other person from enjoyment of such a right'. This should be assessed objectively, taking all the characteristics and circumstances of the transaction into account.

The CJEU observed that Luc Varenne supplied a complicated service consisting of the provision of access to sporting facilities, where it took charge of the supervision, management, maintenance and cleaning of those facilities. It added that, according to the order of reference, the economic value of the various services supplied represented 80% of the charge. The CJEU concluded that this was unlikely to be a letting of immovable property, leaving it to the national court to make the necessary findings of facts.

Comments - The CJEU referred extensively to *Stockholm Lindöpark* (C-2001/34), in which it had found that the letting of a golf course did not constitute a 'letting of immovable property'. This case therefore confirms that the letting of sporting facilities, together with the supply of services, will rarely be exempt as the passive 'letting of immovable property'.

Réegie communale autonome du stade Luc Varenne v État Belge (C-55/14)

Was the supply of pilot training a supply of services?

Summary - The FTT found that the supply of pilot training was the supply of services.

Captain Smith had applied for voluntary registration in January 2013, with an effective date of 14 October 2012. HMRC had denied a claim for input tax refund on costs incurred in obtaining a private pilot licence, on the ground that the expense was incurred in 2011, more than six months before the effective date of registration (reg 111 the VAT Regulations 1995).

The six months cut-off only applies to services. Captain Smith argued that, as confirmed by HMRC's *Business Income Manual* (BIM35660), the pilot licence was an asset of a capital nature. However, the FTT pointed out that, under art 14(1) of the Principal VAT Directive, 'Supply of goods shall mean the transfer of the right to dispose of tangible property'; and the supply of pilot training was not a tangible asset. As VATA 1994 s 5(2)(b) treats anything which is not a supply of goods as a supply of services, the pilot training could therefore only be a supply of services. Furthermore, the HMRC manual referred to by Captain Smith related to income and corporation tax, while the nature and concepts of VAT 'are entirely different'.

Despite having been informed by HMRC that the input tax was not recoverable, Captain Smith had claimed it in his return, with the intention to appeal against HMRC's denial of the claim. The issue was therefore whether HMRC had been right to impose a penalty in these circumstances.

Decision:

In the FTT's view, Captain Smith's return contained an inaccuracy which led to a 'false or inflated claim for repayment' (FA 2007 Sch 24 para 1(2)(b)). The inaccuracy was not careless, as clearly Captain Smith had taken reasonable care, but it was deliberate. The fact that Captain Smith thought that he ought to be able to recover the relevant input tax did not affect the analysis. The penalty was therefore due.

Comments -The FTT criticised HMRC for not referring the taxpayer to the Principal Directive (art 14) sooner, as he may have realised that his case had no chance of success.

Sam Smith v HMRC [2015] UKFTT 0024

Rental invoices

Summary – The Tribunal dismissed an appeal as the rent had not been paid to the landlord

The taxpayer traded as a motor dealer but ceased trading in 2010 as a result of accumulated losses. It had paid rent on its premises to RDL, an associated company. RDL elected to waive the VAT exemption so the rent was subject to VAT and the taxpayer was entitled to claim input tax on the payments.

HMRC disallowed the claim six months after it was made on the basis that the invoices had not been paid to the landlord (VATA 1994, s 26A).

The taxpayer appealed.

Decision:

At the First-tier Tribunal, much discussion concerned whether payment had been indirectly made by internal journals or year-end credits to different loan accounts. The judge ruled that the evidence did not support the explanations and statements of the director. The company was therefore not entitled to credit for the input tax.

The appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, said: "It is oft en forgotten that, if a supplier claims input tax on a supply based on invoice rather than payment date, because he is not using the cash accounting scheme this input tax must be repaid to HMRC if the invoice is overdue for payment by more than six months. The adjustment should be made in the VAT period when the invoice becomes overdue for payment by six months but can then be reclaimed if payment is subsequently made. A common check of HMRC officers is to review the creditors' report of a business to identify possible supplies which are unpaid by more than six months or where a credit note might have been issued by a supplier but left out of the records."

Heanor Motor Company Ltd v HMRC TC4163

Bad debt relief (Lecture B880 – 16.46 minutes)

Basic rules

A business can claim bad debt relief on a VAT return when the following conditions are met:

- The sales invoice in question is more than six months overdue for payment;
- The invoice has been written off in the business records and accounts i.e. the customer's sales ledger account has been credited and a bad debt expense also created; and
- Output tax must have been accounted for on the original sales invoice and declared and paid to HMRC on a VAT return
- The debt must not have been sold, factored or paid under a valid legal assignment.

Note – the latest time a claim can be made is four years and six months after the later of the time of supply (usually invoice date) or due date for payment. If an invoice is written off and bad debt relief has been claimed, then output tax must be declared on any payment subsequently received from the customer. See Example 1.

HMRC Notice 700/18 – para 2.2 (Legislation – VATA1994, s36)

Example 1

Anne's accountant is completing her year-end accounts to 31 March 2014 and identified two unpaid sales invoice that are more than six months overdue for payment:

Invoice 0124 dated 20 June 2013 - £5,000 plus VAT

Invoice 0144 dated 31 July 2013 - £2,000 plus VAT.

Anne does not use the cash accounting scheme and has accounted for output tax on both of the invoices in question according to the invoice date. She is not confident of receiving payment for either invoice (which were made on 90-day payment terms) but feels that it is too premature to write off invoice 0124. It would therefore make sense for her to reclaim £400 bad debt relief on her next VAT return in relation to invoice 0144 but she must write this invoice off in her accounts to create a bad debt expense. VAT of £400 should be claimed in Box 4 of her next return.

Note – a common error with the rules is that sometimes a business claims the relief too early by thinking that the earliest claim date is six months from the invoice date rather than due payment date. The earliest VAT return that Anne could claim bad debt relief on invoice 0144 is therefore the return that includes 30 April 2014.

Consider cash accounting scheme

Do not forget that one of the main advantages of the cash accounting scheme is that bad debt relief is automatic. Output tax is only declared on a VAT return when payment has been received from a customer although input tax cannot be claimed until a supplier has been paid. A business can use the scheme if it expects taxable sales in the next 12 months to be less than £1.35m (excluding VAT). If a business uses the flat rate scheme (FRS), then it cannot use the cash accounting scheme but it can adopt the cash based turnover method, which means that the payment date is again relevant. However, see the final section of this article which highlights an unexpected cash windfall with the bad debt relief rules for FRS users.

The VAT only invoice – Simpson and Marwick case

If you act for any car repair businesses, or legal firms, it is possible that your clients will raise VAT only invoices, usually in relation to insurance work. Think about the situation where a VAT registered car owner is involved in an accident (his fault) where his vehicle repair is the subject of an insurance claim. The repair business will invoice the insurance company for the net amount of the job (let's say £3,000) and invoice the VAT amount (£600) to the business owner as a VAT only invoice – the latter business can claim input tax as a business expense (assuming it is not exempt or partly exempt). But what happens if the car repair business is never paid for the VAT only invoice?

The above question about bad debt relief on VAT only invoices has done the rounds in the tribunals – here is a summary of the outcome in the case of law firm *Simpson and Marwick v HMRC*:

- The First-tier Tribunal (FTT) ruled that the bad debt relief on a VAT only invoice was based on applying the relevant VAT fraction to the VAT in question ie £600 x 1/6 = £100 in the scenario considered above (TC00662)
- The Upper Tribunal (UT) strangely reversed this decision and decided that the bad debt relief in the case of a VAT only invoice was the VAT itself ie £600 ([2011]UKUT 498 (TCC)
- The Court of Session restored sanity and allowed HMRC's appeal ie giving the same conclusion that was reached by the FTT ([2013] CSIH 29 XA45/12.

The key issue (in my opinion) is that in the case of a car repair insurance job for £3,000 plus VAT where the VAT only invoice remains unpaid, the car repair business has still received consideration (£3,000 from the insurance company) for performing a standard rated service so output tax of £500 (i.e. £600 less £100) would appear correct. The decision of the UT effectively meant that our car repairer had earned £3,000 with no tax payable, which cannot be correct.

Flat rate scheme – tax windfall

If I use the FRS and only account for tax when I receive payment from my customers, then I have adopted the cash based turnover method. You might think that bad debt relief is therefore irrelevant because I never account for tax on a sale if I am not paid. However, a quirk of the FRS (good news) is that there is some bad debt relief for me to claim in Box 4 of my VAT return in the period when I write off an unpaid debt in my accounts. See Example 2.

Example 2

Steve uses the FRS and adopts a flat rate of 12% - he completes VAT returns on a calendar quarter basis and uses the cash based turnover method. He raised an invoice for £5,000 plus VAT on 31 December 2013 (30 day payment terms), which he wrote off as a bad debt on 30 September 2014.

Steve can claim £280 in Box 4 of his VAT return for September 2014 under the bad debt relief rules on the following basis:

* If he had been paid for the invoice, he would have collected £1,000 of tax from his customer and then included £720 on his VAT return through the FRS (£5,000 plus VAT x 12%).

* In the absence of payment from the customer, he can therefore claim the difference of £280 (£1,000 less £720) from HMRC under the bad debt relief rules.

Note – if Steve accounted for FRS tax with the basic turnover method (where VAT is usually declared based on the invoice date), his bad debt relief claim would be £1,000 on his September 2014 VAT return ie to reclaim the £720 he would have declared on his December 2013 return based on the invoice date plus the extra £280 windfall that is now due.

(HMRC VAT Notice 733, section 14)

Customers and unpaid purchase invoices

The bad debt relief rules also affect customers as well as suppliers. If a supplier has claimed bad debt relief on his VAT return, it is only fair that the regulations also require the customer to adjust his input tax claim if he has not paid a purchase invoice that is more than six months overdue for payment. The regulations require input tax to be credited by the customer on the VAT return relevant to the date when the six month payment deadline becomes relevant (assuming the payment date is later than the time of the original supply, which is usually the case), but the good news is that input tax can again be reclaimed by the customer if he pays the invoice(s) in the future (VATA1994, s26A). See Example 3.

Example 3

ABC Enterprises Ltd received a purchase invoice dated 31 May 2013 from DEF Wholesalers Ltd for £5,000 plus VAT in relation to stock (60 day payment terms).

The directors of ABC initially refused to pay the invoice because they thought the goods were faulty but eventually paid the invoice on 12 June 2014. ABC does not use the cash accounting scheme and claimed input tax of £1,000 on its June 2013 VAT return ie based on the invoice date.

ABC should have reversed the input tax claim on its March 2014 VAT return because the invoice was still unpaid on 31 January 2014 ie six months after the due payment date of 31 July 2013. However, the company can then reclaim input tax again on its June 2014 VAT return on the basis that the invoice was paid in this period.

HMRC Notice 700/18 – section 4

Contributed by Neil Warren