Tolley®CPD

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Personal Tax

Planning for retirement (Lecture P881 – 18.35 minutes)/ Lecture P882 – 14.05 minutes)

The key changes for pensions from April 2014 were as follows:

- **Capped drawdown** limit increased from 120% to 150% of Government Annuity Table rates,
- Guaranteed income requirement for **flexible drawdown** reduced from £20,000 to £12,000,
- Trivial commutation' value for total pension savings increased to £30,000,
- If total pension funds exceed £30k can take as 100% lump sum from a maximum of three £10k pension pots

The 2014 changes will be relevant for any taxpayer who is over the age of 55 before April 2015. Those currently over the age of 55 might wish to retain "capped drawdown" post April 2015 and this is indeed possible – providing they are in capped drawdown pre April 2015.

Longer term changes to defined contribution schemes from April 2015 were also announced in 2014 and these will have a significant impact on OMBs planning for retirement.

The key change to the tax treatment of defined contribution schemes from April 2015 can be summarised in one word – "flexibility". From April 2015 anybody over the age of 55 can drawdown from their pension fund in any way they please. If they wanted to draw the whole of their defined contribution pension pot the day after their 55th birthday they would be free to do so. There would obviously be tax considerations for such drawdowns but it is the taxpayer's choice as to when and how they draw down their defined contribution pension.

Annuities would still be an option for retiring taxpayers and might well be the preferred option for those who are not prepared to take the investment risk of pension drawdown.

The tax rules have been amended from April 2015 to accommodate the new flexibility for those taxpayers who opt for drawdown.

Flexi-access drawdown

Up to 25% of the value of the fund may be taken as a tax free pension commencement lump sum. Any further draws above the initial 25% lump sum are treated as income of the beneficiary.

One disadvantage of going into drawdown is that an individual in flexi-access drawdown is subject to new *annual allowance rules*, with tax relief on further contributions reduced from £40,000 to £10,000 per year. When subject to the £10,000 annual allowance there will be no carry forward of unused allowance. Drawing the 25% tax free lump sum will not trigger the reduction but any further draws will.

The £10,000 annual allowance is not triggered if the individual just takes their 25% lump sum – it is the subsequent income drawdown that triggers the reduction.

If a taxpayer also has a defined benefit scheme that will continue to enjoy the £40,000 limit but this limit is reduced by the level of qualifying contributions into the defined contribution scheme. So if a taxpayer was in flexi-access drawdown and continued to contribute £5,000 pa into their defined contribution pension then their defined benefit contributions would need to be below £35k to avoid any additional tax liabilities.

Illustration – Flexi-access drawdown

Mr D is 66 and has an income of £7,600 per annum from his State Pension. He has a defined contribution pot of £100,000 and decides to take £55,000 from his pension pot which includes his 25% tax-free lump sum of £25,000, to pay off his mortgage.

Of the £30,000 above the lump sum, £3,000 will be taxed at 0% as, together with his State Pension, it falls within his £10,600 personal allowance. The remaining £27,000 would then be taxed at 20%.

In year 2, Mr D takes the full £45,000 left in his pension pot. Assuming the tax thresholds remain unchanged in year 2 the first £3,000 and his State Pension will be taxed at 0%. The next £31,785 will be taxed at 20% and the final £10,215 will be taxed at the higher rate of 40%.

<u>Uncrystallised funds pension lump sum (UFPLS)</u>

Under this route of drawdown, the first 25% of <u>each draw</u> will be tax free, with the remainder taxable as income.

An individual who is in UFPLS drawdown will thereafter be subject to new *annual allowance rules* with tax relief reduced to £10,000 per year. The defined benefit limit is the balance of £40k as with flexi access drawdown.

The choice between flexi access drawdown and UFPLs is down to when the beneficiary wants to receive their 25% tax free lump sum – **up front or on each draw**.

<u>Why does the £40,000 reduce to £10,000 once in drawdown?</u>

Once in drawdown the annual contribution limit reduces to £10,000 per tax year. The reduction is to reduce the government's exposure to "churning" i.e. making an immediate withdrawl of a pension contribution.

Within the £10,000 limit there is still some scope to provide a useful return:

	20% taxpayer	40% taxpayer	45% taxpayer
	£	£	£
Gross contribution	10,000	10,000	10,000
Tax relief on contribution	(2,000)	(4,000)	(4,500)
Tax free draw (25%)	(2,500)	(2,500)	(2,500)
Taxable draw (75%)	(7,500)	(7,500)	(7,500)
Tax on taxable draw	1,500	1,000	1,125
Taxpayers "Profit"	(500)	(1,000)	(1,125)

Not a bad return for one day!

The taxpayer would need pensionable earnings of at least £10,000 to make this level of contribution but many taxpayers will continue to work after going into drawdown.

Transitional rules

For untouched funds the new rules will apply post April 2015.

Those in capped drawdown prior to April 2015 can continue such an arrangement post April 2015. The advantage in doing so was that they can continue to contribute up to £40,000 pa into their pension fund i.e. they are not subject to the reduced £10,000 limit even though they are in drawdown.

For clients currently over the age of 55 they might want to consider triggering capped drawdown prior to April 2015 if they wanted to preserve the ability to drawdown and make up to £40,000 annual pension contributions.

Those currently in flexible drawdown are currently not permitted to make annual pension contributions. The new rules will allow them to contribute up to £10,000 pa post April 2015.

Death benefits – taxpayer dies < 75

If the taxpayer is in drawdown or has taken no pension taken at all…

If the beneficiary chooses to take the **lump sum option** from the deceased's pension fund the key tax implications are as follows:

- Lump sum is tax free to beneficiary
- Funds no longer in pension contract
- Pension pot tested against lifetime allowance of the deceased
- Pension not part of inheritable estate of deceased

If the beneficiary chooses to take the **drawdown (or annuity) option** from the deceased's pension pot the key tax implications are as follows:

- No tax on fund at point of transfer
- Income will be tax free for beneficiary
- Pension pot not tested against lifetime allowance of the deceased
- Pension not part of inheritable estate of the deceased

If the deceased has taken an annuity then any resultant benefits will be tax free to the surviving beneficiary.

Death benefits - taxpayer dies > 75

If the taxpayer is in drawdown or has taken no pension taken at all…

If the beneficiary chooses to take the **lump sum option** from the deceased's pension fund the key tax implications are as follows:

- Lump sum is subject to a 45% charge but this planned to reduce to beneficiary's marginal rate from 2016/17
- Pension pot not tested against lifetime allowance of the deceased
- Pension not part of inheritable estate of deceased

If the beneficiary chooses to take the **drawdown (or annuity) option** from the deceased's pension pot the key tax implications are as follows:

- No tax on fund at point of transfer
- Income will be taxed at marginal rate of beneficiary
- Pension pot not tested against lifetime allowance of the deceased
- Pension not part of inheritable estate of the deceased

If fund already taken as an annuity then value protection lump sum taxed at 45% although this is expected to change to the marginal tax rate from 2016/17

Next steps

Take advice early and carefully plan the use of your fund(s). This advice must be updated regularly.

Both spouses should aim to have pension pots.

- Start to shift contributions to spouse?
- Aim is to utilise both base rate bands in retirement
- If either spouse dies < 75 you have a "tax free wrapper"

If one spouse dies under the age of 75 and the surviving spouse has enough other income to live comfortably then maybe the pension pot should pass to the children. The pension fund can be withdrawn tax free – to pay school fees, pay off a mortgage etc.

In many clients the "non-working" spouse would take a director's salary around £8,000 plus dividends. Consistent pension contributions at £8,000 would build up a reasonable fund in retirement. If the company is not utilising their £2,000 employers NIC holiday each year then it may be worth increasing the spouses directors salary to the personal allowance so as to increase the ability to make pension contributions.

Whilst the new pension rules offer planning opportunities for your OMB clients it is important to emphasise that drawdown has an element of risk. If the stock market falls then a fund in drawdown is also likely to fall. Drawdown products are likely to become very refined under this new system so there should be ways to minimise risk but drawdown is always likely to carry more risk than the annuity route.

Clients will also have to be very aware of how much they draw each year – balancing current and long term financial needs.

These opportunities look too good to be true, will they change in future?

Will high rate contribution relief survive the next Parliament? Maybe not – should we be advising clients to take advantage of the current high rate reliefs.

Contributed by Dean Wootten

Private expenditure

Summary – The tribunal found that the director's loan account was incorrect and therefore tax was assessed under s203 ITEPA

The director of a company used his company credit card for business and private expenditure. HMRC concluded that there were no controls in place to quantify the private amount and, as a result, the director's loan account was incorrect. They therefore raised assessments charging tax under ITEPA 2003, s 203 (cash equivalent of benefit treated as earnings).

The taxpayer appealed.

Decision:

The First-tier Tribunal noted that no evidence had been provided to HMRC to show that the director had reimbursed the company for the private expenditure or adjusted the director's loan account.

Given that the taxpayer could not offer evidence to show the assessments were wrong, the tribunal confirmed the assessments.

The taxpayer's appeal was dismissed.

The tribunal reached a similar decision in *F Roberts* (TC4235).

Comments – This case although fairly basic demonstrates the importance of correctly dealing with private expenditure. It is a timely reminder as we are coming up to the P11D season.

D White v HMRC TC4234

Was a pension plan established in the US?

Summary - The UT found that a pension plan was established in the US for the purpose of double tax treaty relief.

Mr Macklin received a pension from the World Bank's staff retirement plan (SRP). The World Bank is an international organisation based in Washington. It is the SRP's trustee and the management and administration of the SRP is carried out in Washington.

The issue was whether art 17(1)(b) of the UK/US double tax treaty (the DTA) entitled Mr Macklin to claim partial exemption from UK income tax on his pension. This depended on whether the SRP was 'established in' the US. Mr Macklin argued that the words 'established in' should be given their ordinary meaning and that they refer to the geographic location of where a pension scheme is set up, funded, managed and administered. By contrast, HMRC contended that the word 'established' meant 'established under and in conformity with the relevant Contracting State's tax legislation'. The SRP was exempt from US tax by concession from the IRS, as a result of the privileges and immunities enjoyed by the World Bank. In HMRC's view, it was therefore not 'established in' the US.

Decision:

The UT noted that under the Vienna Convention, a treaty must be interpreted in accordance with the 'ordinary meaning' of its terms. Furthermore, the DTA did not state expressly that for its purposes, a pension scheme must be established in conformity with the relevant contracting state's tax legislation. The UT also referred to The *Oxford English Dictionary*, which defines 'establish' as 'to set up on a secure or permanent basis'. The UT concluded that 'established' referred to the scheme's physical location.

Comments - The UK/US double tax treaty follows the OECD's model convention. The UT's interpretation of 'established' could therefore be relevant in relation to a large number of double tax treaties.

Michael Macklin v HMRC [2015] UKUT 0039

Human Rights Act challenge

Summary - The UT found that the FTT had been right to find that a case had no prospect of success.

The company of which Mr Allan was a shareholder and director had set up a pension scheme and had made a non-cash contribution (in the form of treasury stock) to the scheme for the benefit of Mr Allan. Mr Allan had filed his tax return on the basis that the contribution by his employer did not give rise to a charge to income tax under ITEPA 2003 s 386, because the treasury stocks were non-cash assets and therefore not 'a sum paid'.

Since then, the Court of Appeal in *Irving* [2008] EWCA Civ 6 had determined that point of construction against Mr Allan's interpretation. While accepting that *Irving* was binding on the UT, the appellant contended that he had a reasonable prospect of ultimate success at the Court of Appeal or the Supreme Court; and so the FTT had been wrong to strike out the appeal on the ground that it had 'no reasonable prospect' of success. He submitted that in *Irving*, the Court of Appeal had taken neither the Human Rights Act 1998 s 3 into account, nor the European Convention on Human Rights art 1 protocol 1 (A1P1). Applying s 3 in compliance with A1P1 would lead to an interpretation which would not depend on factors particular to the applicant.

Decision:

The Court of Appeal, however, considered that the distinction suggested by Mr Allan between contributions in cash and contributions in asset form was 'arbitrary/absurd/irrational'. It was therefore doubtful that such an interpretation, although permissible as a matter of ordinary language, could be said to be 'possible' and within the meaning of s 3. As for A1P1, it is always relevant where tax is concerned, as it relates to the right to enjoyment of one's possessions. However, given that s 386 is not arbitrary, retrospective or discriminatory and that it contains safeguards, including effective means of challenge, A1P1 was of no help to the appellant.

Comments - After a previous challenge based on the Bill of Rights (see *Wayne Pendle v HMRC)* this was another usual challenge based on the Human Rights Act and the ECHR. Like that challenge, it failed.

Mark Allan v HMRC [2015] UKUT 0016

Is your benefit trivial? (Lecture B881 – 5.46 minutes)

In his Budget last year, the Chancellor announced a number of measures aimed at simplifying the administration of employee benefits and expenses. This followed a detailed review conducted by the Office of Tax Simplification (OTS) into this important area.

One of the OTS recommendations was that there should be a statutory exemption for 'trivial' benefits in kind provided for employees. This, it was suggested, should replace what has hitherto been a concessionary practice, under which an employer has had to agree with HMRC whether a benefit can be regarded as 'trivial' (and therefore not liable to income tax or NICs).

The recent Finance Bill has introduced just such a provision. A new S323A ITEPA 2003 states that any benefit provided by, or on behalf of, an employer to an employee (or to his family or household) will not be chargeable to income tax where four conditions are satisfied. There will be a corresponding NIC exemption.

The four specified conditions are as follows:

(i) The benefit must not be cash or a cash voucher as defined in S75 ITEPA 2003.

(ii) The cost of providing the benefit must not exceed £50 per person. If the benefit is provided to a number of persons such that it would be impracticable to calculate the cost of providing it to each one individually, a simple average cost mechanism can be used.

(iii) The exemption will only be in point where the benefit is not provided as part of a salary sacrifice arrangement or other contractual obligation.

(iv) The benefit must not be provided in recognition of services performed by the employee in the course of the employment or in anticipation of such services.

This new section has effect for 2015/16 onwards. Any benefit which is exempted under S323A ITEPA 2003 will not have to be reported to HMRC by the employer.

Contributed by Robert Jamieson

Capital Taxes

Gain belongs to taxpayer

Summary – The taxpayer was correctly assessed upon a gain on a residence as it did not qualify for PPR relief

In September 2006, the taxpayer bought a house for £110,000 and gave it to his girlfriend in March 2007. In that time, the property's value increased to £132,500. He never lived in the property and did not show the gain in his tax return.

HMRC assessed the gain to capital gains tax and imposed a penalty for fraudulent delivery of a return. The taxpayer appealed.

Decision:

The First-tier Tribunal found that the taxpayer did not use the house as his only or main residence, and neither was the transfer of the property exempt because it was not between spouses or civil partners. The fact that the taxpayer chose not to charge his girlfriend was irrelevant — the gain remained his personal capital gain.

The taxpayer's appeal was dismissed.

Comments – It is amazing how taxpayers can contemplate that CGT is not payable on a house when it is clearly not a principal private residence. This is a common relief but it has conditions that must be met. It must arguably be the most misunderstood relief so yet another absolutely black and white decision with no room for argument.

P Brookes v HMRC TC4252

Plan C for relevant property trusts (Lecture P883 – 27.27 minutes)

On 31 May 2013, HMRC published a consultation document entitled ‘Inheritance Tax: Simplifying Charges on Trusts – The Next Stage’. The main purpose of this paper was to outline ways in which 10-year anniversary and exit charge calculations for relevant property trusts (eg. discretionary settlements) could be made more straightforward. As part of this process, HMRC proposed that the IHT nil rate band should be split equally between all relevant property trusts created by the settlor instead of continuing with the present system under which many settlements are entitled to a full IHT nil rate band of their own.

This proposal was clearly intended to counter the established practice of setting up multiple pilot trusts to which substantial property would be added in due course – often on death – in order to minimise IHT charges on the trusts going forward. It should be noted that the Court of Appeal accepted such arrangements in *CIR v Rysaffe Trustee Company (CI) Ltd (2003)*. In addition, Para D26.6.1 of the GAAR Guidance confirmed that the use of pilot trusts was ‘not regarded as abusive’.

However, the proposed idea did not go down well with most of the parties who commented on the document and when the notes from the 2013 Autumn Statement said:

'The Government will consult on proposals to split the IHT nil rate band available to trusts with a view to delivering this change alongside simplification of the trust calculations in 2015.'

it was clear that some sort of rethink was in the offing.

On 6 June 2014, there was an announcement of a further consultation document called 'Inheritance Tax: A Fairer Way Of Calculating Trust Charges'. In effect, this was HMRC's Plan B.

The main details of this second proposal were that every individual would be entitled to a single 'settlement nil rate band' (SNRB) which was to be equivalent to the existing IHT nil rate band. Each settlor was responsible for deciding how this SNRB was to be shared between his trusts when it came to calculating the tax on a 10-year anniversary or exit charge in relation to those settlements. Broadly, this revised regime was only to apply to new trusts created on or after 7 June 2014 – thus trusts set up before 7 June 2014 were to be protected from these changes. Formal SNRB elections were needed which specified, in percentage terms, how much SNRB was to be allocated to each settlement.

Unfortunately, this plan, although in many respects a great deal more satisfactory than its predecessor, still did not find favour with the main professional bodies and other influential commentators. As a result, it also bit the dust and, on 3 December 2014, the Chancellor announced what has become HMRC's Plan C, the details for which were unveiled in the draft Finance Bill.

The intention is to limit the advantages of multiple trusts by ensuring that, where value is added to two or more settlements simultaneously, the value of such additions will in future have to be taken into account for the purpose of calculating the IHT charges for 10-year anniversaries and exits. A new concept of 'same-day additions' has been introduced by S62A IHTA 1984. This occurs if the settlor of two or more settlements, which are not related settlements under S62 IHTA 1984, has added value to such trusts on the same day. Where this has happened in relation to taxable events on or after 6 April 2015, the subsequently added value must be included in any trust tax calculation together with the initial value of the property in the other trust(s).

A comparison of the tax results under the current rules and under HMRC's proposed alternative is set out below. The illustration looks at a 10-year anniversary charge and assumes that the present IHT rates and nil rate band remain in place for the time being.

<u>Illustration 1</u>

Christopher, whose cumulative total of chargeable transfers stood at £10,000, set up Pilot Trust A with £10 on 1 June 2015 and Pilot Trust B with another £10 on 2 June 2015. They are both discretionary settlements.

Christopher died on 1 January 2016 and his will instructed that £250,000 should be added to each trust.

When the first 10-year anniversary charge arrived in June 2025, the value of the property in each trust was:

Trust A (1 June 2025)	£340,000
Trust B (2 June 2025)	£340,000

There have been no exit charges.

Current rules

The IHT payable in connection with the 10-year anniversary charge on Trust A is calculated as follows:

	£
Christopher's chargeable transfers prior to Trust A	10,000
Add: Value of Trust A property on 1 June 2025	340,000
	£350,000

IHT at lifetime rates on the value of Trust A's property is:

	£
On 10,000 – 325,000 = 315,000 @ 0%	–
On 325,000 – 350,000 = 25,000 @ 20%	5,000
	£5,000

Thus:

5,000/340,000 x 100 = 1.471%

On the assumption that the 10-year anniversary charge is wholly ascribable to the addition on 1 January 2016 (ie. the initial value settled is ignored), the number of quarters taken is 40 less the number of complete successive quarters prior to the addition – this comes to two. And so the fraction becomes 38/40ths.

The rate of IHT actually charged is:

1.471% x 30% x 38/40 = 0.419%

Therefore, the trustees of Trust A must settle a liability of 0.419% x £340,000 = £1,425.

The 10-year anniversary tax calculation for Trust B is taken to be the same, ie. another £1,425.

Proposed alternative

The IHT payable in connection with the 10-year anniversary charge on Trust A is calculated as follows:

	£	£
Christopher's chargeable transfers prior to Trust A		10,000
Add: Value of Trust A property on 1 June 2025	340,000	
Value of same-day addition to Trust B	250,000	
Initial value of Trust B	10	
		590,010
		£600,010

IHT at lifetime rates on the chargeable value for Trust A is:

	£
On 10,000 – 325,000 = 315,000 @ 0%	–
On 325,000 – 600,010 = 275,010 @ 20%	55,002
	£55,002

Thus:

55,002/590,010 x 100 = 9.322%

Making a similar assumption to the previous calculation, the rate of IHT actually charged is:

9.322% x 30% x 38/40 = 2.657%

Therefore, the revised liability for the trustees of Trust A is 2.657% x £340,000 = £9,034, with the same sum being due from the trustees of Trust B, ie. a more than sixfold increase.

It should be noted that, if either of the settlements can be classified as a 'protected settlement', the new regime is not in point. S62B IHTA 1984 defines a protected settlement as a trust which commenced before 10 December 2014 where either Condition A or Condition B is met.

Condition A is that there have been no transfers of value by the settlor on or after 10 December 2014 as a result of which the value of the trust property has increased. Thus a pre-10 December 2014 settlement to which there have been no subsequent additions is not caught.

Condition B is that there has been a post-9 December 2014 transfer of value into the trust which took place on the settlor's death where, as a result of a recent modification to the settlor's will, the trust addition is in substance the same as it was immediately before 10 December 2014. However, this let-out in Condition B only applies if the settlor died before 6 April 2016.

Finally, when looking at same-day additions, there is no requirement that these transfers must all be going into a relevant property trust. Thus, if £100 was added to a disabled person's trust as part of a same-day addition and that trust was originally funded by a potentially exempt transfer of £5,000,000, the £5,000,000 initial value must be included in the IHT calculation. That cannot be right!

Contributed by Robert Jamieson

ATED in 2015 (Lecture B883 – 17.20 minutes)

ATED is an annual tax payable by non-natural persons such as companies and corporate partnerships which own UK residential property valued at more than £2,000,000.

The ATED chargeable period is linked to financial years, ie. it runs from 1 April in one year to 31 March in the next. The amount of tax charged is based on the value of the property on a particular date. The annual chargeable amounts are subject to indexation by reference to the previous September's Consumer Prices Index (rounded down to the nearest £50). However, Parliament can override the normal indexation by including a specific provision in the Finance Bill. This is what has happened for 2015, given the Chancellor's announcement of an increase in the ATED charges for the year to 31 March 2016 by '50% above inflation'. The tax figures for this chargeable period, taking into account the fact that the Consumer Prices Index grew by 1.2% in the year to September 2014, are:

Property value	
	£
More than £2,000,000 but not more than £5,000,000	23,350
More than £5,000,000 but not more than £10,000,000	54,450
More than £10,000,000 but not more than £20,000,000	109,050
More than £20,000,000	218,200

These are huge increases over the previous year's figures and are likely to cause some property owners to review their holding structures.

In addition, it was legislated in FA 2014 that, with effect from 1 April 2015, a new band would come into play for properties with a value of more than £1,000,000 but not more than £2,000,000, with this band being subject to a charge of £7,000 for the first year. The charge of £7,000 has not been increased.

With effect from 1 April 2016, a further new band will be introduced for properties with a value of more than £500,000 but not more than £1,000,000 where the annual ATED charge will initially be £3,500. This is also unchanged.

As was the case in 2013, those falling into the band being brought in on 1 April 2015 will have until 1 October 2015 in which to file their first ATED return and until 31 October 2015 in which to pay the tax, reverting to the regular 30 April deadline thereafter.

The ATED-related CGT charge will bite for disposals made on or after 6 April following the introduction of the applicable ATED band (ie. from 6 April 2015 and 6 April 2016 respectively) and will only be levied on gains accruing from the relevant starting date onwards.

Other ATED amendments cover the following:

(i) Under ATED, the amount of tax charged is based on the value of the dwelling as at 1 April 2012 and thereafter at five-yearly intervals. It was the Government's policy intention that a chargeable person, who has a property interest which falls within ATED because of its value on, say, 1 April 2017, had to file a return for that amount for the chargeable period beginning on 1 April 2018. This was to provide sufficient time to value the property in 2017 and submit a return by the due date of 30 April 2018. However, because of the way in which FA 2013 was drafted, this chargeable person would in fact have to value their property on 1 April 2017 and file their return 30 days later. This is patently unreasonable and so the anomaly has been corrected by the recent Finance Bill with a view to achieving the Government's original intention.

(ii) As mentioned above, the Government announced last year that the £2,000,000 ATED entry threshold was to be lowered in stages to £500,000. Recognising the additional administrative burden on businesses which hold residential property worth over £500,000, and in particular those entitled to claim one of the ATED reliefs, the Government published on 22 July 2014 a consultation document on ways to simplify the administration of ATED. Accordingly, the Finance Bill has introduced a new type of ATED return known as a 'relief declaration return'. For each category of relief being claimed, the business has to submit a single return, stating that relief is being claimed in respect of one or more properties held at the relevant time. No details are required of the individual properties or of the number of properties which are eligible for the relief. A normal ATED return is required, as now, in respect of any property which does not qualify for relief or which ceases to qualify, ie. where tax is due. The overall result is that businesses with properties which qualify for relief will only be required to deliver one relief declaration return per annum for all properties covered by the particular relief instead of the present requirement of having to deliver multiple detailed returns for each property. This will produce a significant reduction in the overall administrative burden.

(iii) Both these changes have effect for chargeable periods beginning on or after 1 April 2015.

Contributed by Robert Jamieson

The reform of SDLT (Lecture B884 – 24.04 minutes)

The biggest surprise which came out of the Autumn Statement on 3 December 2014 was the Chancellor's announcement about the abolition of the long-established 'slab' system for SDLT on residential property acquisitions and its replacement with a progressive sliding scale (usually referred to as a 'slice' system).

Previously, SDLT had been calculated by reference to a percentage of the chargeable consideration for the property. Since 2012, the relevant table has been as follows:

Purchase price	*Rate*
Up to £125,000	0%
Over £125,000 and up to £250,000	1%
Over £250,000 and up to £500,000	3%
Over £500,000 and up to £1,000,000	4%
Over £1,000,000 and up to £2,000,000	5%
Over £2,000,000	7%

Thus the SDLT on a property costing £760,000 in April 2014 was 4% x £760,000 = £30,400.

The main criticism of the 'slab' system was its distorting 'cliff edge' effect. For example, if a house was priced at £499,900, the SDLT was 3% x £499,900 = £14,997. If, instead, it had cost £500,100, the SDLT would have been 4% x £500,100 = £20,004. In other words, the addition of £200 to the purchase price would have cost the buyer an extra £5,007 in SDLT. This represents an impressive (but iniquitous) marginal rate of tax!

Purchasers of residential property who complete on or after 4 December 2014 are subject to a completely different regime (which is much closer to the structure of income tax). The new rates are:

Purchase price	*Rate paid on part of price falling within each band*
Up to £125,000	0%
Over £125,000 and up to £250,000	2%
Over £250,000 and up to £925,000	5%
Over £925,000 and up to £1,500,000	10%
Over £1,500,000	12%

If the property above was instead bought in April 2015, the SDLT calculation goes as follows:

	£
On 125,000 @ 0%	–
On 125,000 @ 2%	2,500
On 510,000 @ 5%	25,500
	£28,000

This produces a saving of £30,400 – £28,000 = £2,400, compared with the same property being bought 12 months earlier.

HM Treasury have stated that the new SDLT rates will be the same as or (usually) lower than the old rates for purchases of houses and flats costing up to £937,500 – this is the break-even point. However, it should be noted that not all properties which are more expensive than this amount will have higher SDLT charges. For example, a residential property priced at £1,005,000 will now cost the buyer:

	£
On 125,000 @ 0%	–
On 125,000 @ 2%	2,500
On 675,000 @ 5%	33,750
On 80,000 @ 10%	8,000
	£44,250

in tax, whereas, under the old regime, the SDLT charge would have worked out at 5% x £1,005,000 = £50,250.

SDLT is payable when a property transaction is completed by the purchaser. As a result, the legislation has had to include a number of transitional measures for deals which took place towards the end of last year. For example, where contracts for the purchase of a property were exchanged before 4 December 2014 but the contract is not completed until on or after that date, purchasers can, if they wish, choose not to apply the new 'slice' rules so that they will end up paying SDLT under the old regime.

<u>Illustration 1</u>

Contracts were exchanged for the purchase of a house by Alastair for £360,000 on 13 November 2014 and the purchase was completed on 23 January 2015.

Under the new SDLT rules, the tax payable by Alastair is:

	£
On 125,000 @ 0%	–
On 125,000 @ 2%	2,500
On 110,000 @ 5%	5,500
	£8,000

Under the old rules, the SDLT is calculated as 3% x £360,000 = £10,800.

Alastair can choose whether to pay £8,000 or £10,800 by entering the appropriate amount on the land transaction return. In this case, Alastair will clearly go for the new rules.

Illustration 2

Contracts were exchanged for the purchase of a London flat by Denis on 25 October 2014. Completion took place on 9 January 2015.

Under the new SDLT rules, the tax payable by Denis is:

	£
On 125,000 @ 0%	–
On 125,000 @ 2%	2,500
On 675,000 @ 5%	33,750
On 325,000 @ 10%	32,500
	£68,750

Under the old rules, the SDLT is calculated as 5% x £1,250,000 = £62,500.

In this situation, Denis will opt for the old regime. Notice that, with transitional transactions, the purchaser is always entitled to choose the lower tax figure.

But what happens if the land transaction return has already been submitted under the new rules and the purchaser (eg. Denis in Illustration 2) wishes to pay under the 'slab' system? In that case, it is possible to amend the return within a period of 13 months following the date of completion. Care should be taken to ensure that this time limit is not overlooked.

There are a number of general points about property transactions which need to be borne in mind:

(i) Because SDLT is charged on the actual consideration given by the purchaser in money or money's worth, a gift of property is exempt.

(ii) Note that there is no special exemption for transfers between spouses (or civil partners). In other words, if a wife buys a half-share of a house from her husband, she will be liable for SDLT at the normal rates. In practice, it is more common for spousal transactions to be gifts, in which case there is no SDLT.

(iii) The assumption of a debt by the acquirer of property counts as consideration given and SDLT will apply to the amount of debt assumed. In other words, if A gives a property worth £800,000 to his friend, B, but the property is charged with a £250,000 mortgage which B takes over, there will be no SDLT on the equity gifted. However, there will be a tax charge on the value of the mortgage taken over.

(iv) Occasionally, in the context of SDLT, a deemed market value rule can apply to properties. The most common scenario is when a property is transferred to a connected company – see S1122 CTA 2010 for the definition of this term. SDLT is payable, based on the market value of the property acquired by the company.

Rather oddly, there is no change to the rules for SDLT on the acquisition of non-residential property. Thus commercial property transactions are still subject to tax on the 'slab' basis, as are acquisitions of 'mixed use' properties, ie. properties where there is both residential and non-residential use.

The factors determining whether a particular property is residential or not have been well summarised by one commentator as follows:

'The status of a residential house or flat is normally clear-cut and, in HMRC's view, this is based on its use at the effective date of the transaction. This overrides any past or intended future use. However, if an unused building was last used as a dwelling, it is generally taken to be "suitable for use as a dwelling" in the absence of any contrary evidence. Similarly, an existing building is treated as a dwelling if it is being adapted or marketed for, or restored to, domestic use (see HMRC's Stamp Duty Land Tax Manual at Para SDLT29955).

Various properties are specifically excluded from being residential, for example, student halls of residence, care homes, hospitals and hospices.'

Finally, there is a particularly important deeming rule in S116(7) FA 2003 which applies to the transfer of six or more separate dwellings in a single transaction. This treats them collectively as non-residential for SDLT purposes. It is understood that, with the SDLT cost for upmarket residential properties (particularly in London and the South-East) having risen sharply as a result of the recent Autumn Statement, some property businesses have been taking advantage of this rule by acquiring an expensive London residence plus another five modest houses in, say, Gateshead as a job lot. This means that the SDLT is limited to the 4% maximum for commercial properties rather than the present 12% for residential properties.

Contributed by Robert Jamieson

Administration

Winding up and the jurisdictions of the Companies court and the FTT

Summary - The Court of Appeal found that the Companies Court should have considered a winding-up petition, even though a tax appeal was pending.

The issue was whether, when there is both an appeal against a VAT assessment pending in the FTT, and a winding-up petition pending in the Companies Court, the FTT or the Companies Court is the appropriate forum to determine whether the appeal (against the debt represented by VAT assessments) has a real prospect of success. HMRC contended that the company had purportedly entered into a small number of extraordinary high value export transactions each month to reduce its VAT liability.

Decision:

When deciding whether the Companies Court should have deferred to the FTT, the court observed that the presentation of a petition to wind up a trader, which has appealed against a tax assessment, is not an indirect way of winning the appeal. When the Companies court exercises its discretion to make a winding-up order, it is not only concerned with the particular debt upon which a particular petition may be based. That discretion is therefore not abrogated by the jurisdiction of the tax tribunal.

Because the Companies Court had 'abdicated its discretion to the tax tribunal', the court of appeal turned to the merits of the application. The court found that 'the discrepancies that HMRC had highlighted in relation to the supposed export transactions were simply too numerous and too clear to admit of any conclusion other than that the export did not take place'. The court concluded that the judge should have found that the assessments were not disputed in good faith on substantial grounds and have exercised his discretion to wind up the company.

Comments - The case highlights the fine line which exists between the jurisdiction of the Companies Court considering a winding up petition and that of the FTT considering unpaid assessments. Despite the fact that a decision of the FTT is a compelling factor for the Companies Court, it should not abdicate its own jurisdiction.

HMRC v Changtel Solutions UK [2015] EWCA Civ 29

Human rights not breached

Summary – The Tribunal found that the penalties were correct and the taxpayer's human rights were not breached

A building contractor took on subcontractors in the years ended 5 April 2005, 2006, 2007 and 2008 without accounting for tax at source.

In October 2010, HMRC imposed penalties under TMA 1970, s 98A(2) for failing to make monthly returns as required under the Income Tax (Construction Industry Scheme) Regulations 2005.

The taxpayer appealed on the basis that he had co-operated with HMRC and the penalties were excessive. HMRC offered to mitigate them from £11,900 to £3,376.58.

Decision:

The First-tier Tribunal noted that the taxpayer had operated the construction industry scheme for several years and was aware of his responsibilities. The principles in *A Bosher v HMRC* (UT [2013] UKUT 579) applied: in effect the tribunal had no power to mitigate the penalties and was entirely a matter for HMRC; the absence of a power in the tribunal to mitigate a penalty on appeal did not infringe the European Convention on Human Rights.

The penalties were correct and the taxpayer's appeal dismissed.

Comments – The case demonstrates that when the charge re breaching Human rights is raised it is always considered carefully. The rest of the decision was not unexpected.

R F Farrow v HMRC TC4241

Meaning of "from"

Summary – The Tribunal found that a notice was given within the appropriate time frame by HMRC and was therefore valid.

On 31 January 2012 at 2.30pm, the company filed its self-assessment return for the accounting period to 31 March 2011. On 31 January 2013, HMRC issued a notice enquiring into the return. The taxpayer said HMRC were out of time because the enquiry window had closed on 30 January 2013. Six months later, the department issued an information notice under FA 2008, Sch 36.

The taxpayer appealed.

Decision:

The First-tier Tribunal said the appeal centred on the word "from" in FA 1998, Sch 18 para 24(2) "… notice of enquiry may be given at any time up to 12 months from the filing date". The judge concluded that "from" in this instance was similar to "after", so the enquiry window should exclude the day on which the return was filed. On this basis, HMRC's enquiry notice, having been delivered on 31 January 2013, was within 12 months of the filing date. The notice was therefore effective.

The taxpayer's appeal was dismissed.

Comments – This case demonstrates the importance of the exact wording of the legislation. The judge concluded that "from" in this instance was similar to "after", so the enquiry window should exclude the day on which the return was filed.

Dock and Let Ltd v HMRC TC4056

Confiscation orders and tax

Summary - The FTT found that monies paid under a confiscation order had included tax.

Mr Higgins appealed against income tax assessments (together with interest and penalties) on the ground that he had already accounted for the same under a confiscation order arising from his conviction by the Crown Court for non-compliance with the legislation on the disposal of toxic waste. He contended that assessments had been raised by the National Crime Agency (NCA), having adopted the powers of HMRC under POCA 2002. The issue of the assessments therefore amounted to a double recovery.

Decision:

The FTT observed that the Confiscation Order for a gross amount of £400,000 had represented the best that Mr Higgins could afford, out of a much larger figure of £1.66m representing all the benefits he had received from his criminal activity. Had he paid the larger amount, it would have included his liability to income tax.

It was therefore open to the NCA to consider assessments under TMA 1970. Any additional payments would need to be proportionate. It was therefore necessary to assess the amount of tax which had been included in the £400,000 payment and to deduct it from the assessments. The appeal must therefore be allowed in part.

Comments - The FTT highlighted the confusion between the parties as to the make up of the confiscation order. In similar circumstances, counsel for the taxpayer should therefore obtain/agree a breakdown of the confiscation order.

Malachy Higgins v The National Crime Agency TC4259

Stay of proceedings pending decision by the CJEU

Summary - The FTT dismissed HMRC's application to stand the case over pending a decision of the CJEU.

Open Heavens operates a 'free to air' television channel, earning its income through advertising and sales of programme rights. It considers that it engages in a wholly business activity and is entitled to recover all its input tax. HMRC accepts that the sale of CDs, DVDs and advertising space are business activities, but it does not accept that the production and broadcasting of programmes are. HMRC therefore considers that Open Heavens is only entitled to recover a portion of input tax.

Open Heavens appealed against HMRC's decision in June 2014. In September 2014, HMRC applied for the appeal to be stood over, pending the CJEU's decision in *Sveda* (C-126/14) which was expected 'in the next 18 months'.

Decision:

Agreeing with Open Heavens, the FTT found that the CJEU's decision in *Sveda* would not be of material assistance and that a stay would cause serious prejudice to the company. The FTT noted in particular that there was ample case law on the point, for instance, *Longridge* [2014] UKUT 504; this case examined the dividing line between non-profit activities which amount to the furtherance of a business and those which do not. Furthermore, the fact that the decision of the CJEU was not expected for another 18 months, and that Open Heavens would be precluded to recover the input tax it had claimed during that time, would adversely impact the company.

Comments - The case reminds us that the fact that a decision of the CJEU is expected on a similar point is not sufficient to obtain a stay of proceedings in circumstances where: (a) there is domestic case law on the point; and (b) a stay would adversely affect one of the parties.

Open Heavens Media v HMRC [2015] UKFTT 0042

Damages on an undertaking given by HMRC

Summary - The High Court ordered an inquiry as to damages on an undertaking given by HMRC.

HMRC had suspected that Abbey was heavily involved in the fraudulent evasion of excise duty on alcoholic goods. It successfully presented a petition to wind up Abbey, together with an application for the appointment of a provisional liquidator.

Counsel for the provisional liquidator immediately applied for a worldwide freezing order against three out of Abbey's four directors and issued misfeasance proceedings against these directors. At the misfeasance proceedings, the High Court found that there had been no evasion of duty in relation to the relevant assessments, but the liquidator refused to appeal against HMRC's assessments. The directors were subsequently authorised to appeal to the FTT on behalf of Abbey. Two days before the hearing, HMRC withdrew the assessments, the appeal was allowed and HMRC was ordered to pay costs.

Abbey was applying for an inquiry as to damages on the undertaking given by HMRC on the appointment of the provisional liquidator. The High Court noted that 'in deciding whether to order an inquiry as to damages, the court is entitled to have regard to the fact that the allegations of fraud which were an essential element in the application for the appointment of a provisional liquidator have been considered and rejected in the one set of proceedings in which it was always envisaged that they would be determined'.

Decision:

The High Court also rejected contentions that the directors should have opposed the winding-up petition or applied for an inquiry earlier; after the order, they no longer had access to the company's funds or to any helpful evidence.

The High Court ordered an inquiry as to damages suffered by Abbey as a result of the appointment of the provisional liquidator. It further directed that the inquiry was to proceed on the basis that Abbey would not have been wound up on HMRC's petition.

Comments - Richards J concluded: 'I am concerned that HMRC remains reluctant to recognise those consequences (of its ill-judged litigation). It has already cost HMRC some £2.5m and it seems to me that, if this has not already been done, its position should be considered at a very high level within HMRC.' Note this case involves Abbey Forwarding in the High Court rather than the case reported from the FTT in last month's notes.

Abbey Forwarding v HMRC [2015] EWHC 225

Lack of consideration

Summary – The FTT reduced a penalty due to lack of consideration of special circumstances

The taxpayer was issued a tax return for 2012/13 with a deadline of 20 May 2014. He filed it on 12 August 2014 and HMRC imposed a late filing penalty. The taxpayer's accountants said that the taxpayer had a reasonable excuse because they had submitted form 64-8 in respect of the taxpayer in January 2014 requesting a unique taxpayer reference (UTR). They said HMRC had not dealt with this until 8 July 2014 and did not tell them that a tax return had been issued.

Decision:

The First-tier Tribunal found that the return had been filed late. The taxpayer had no reasonable excuse because he should have shown the accountants the notice to file, which included his UTR, sent by HMRC in the February.

The tribunal said that HMRC had not considered "special circumstances" (FA 2009, Sch 55). The judge noted that HMRC's statement of case included the sentence: "HMRC have considered special reduction but their view is that there are no special circumstances which would allow us to reduce the penalty."

This appeared to be a "standard form sentence" included in several statements of case, even though some of them had been prepared by different Revenue officers. He said there was no evidence to show that this question had been considered by HMRC. Yet, where mitigating factors might exist, HMRC should make clear that they have considered those factors even if they fall short of a reasonable excuse.

HMRC's failure to consider special circumstances meant that their decision was "flawed". As a result, the tribunal was entitled to vary the penalty because of special circumstances. The judge considered that HMRC's failure to act on form 64-8 was a contributory factor to the taxpayer's failure to file on time and so the penalty should be reduced to £60.

The same tribunal reached a similar conclusion in *Rosie Arnfield* (TC4262).

Comments – see parallel case below

John Arnfield v HMRC TC4261

Late filing penalty and special circumstances

Summary - The FTT reduced a penalty due to lack of consideration of special circumstances.

HMRC had imposed a late filing penalty, but Mrs Arnfield's accountants contended that they had registered as agents — filing form 64-8 — and that HMRC had not informed them that a tax return had been issued.

Decision:

The FTT found that the return had been filed late and that a penalty was prima facie due. It added that the taxpayer had no reasonable excuse, as she should have showed her accountants a letter sent by HMRC in February and containing her UTR.

The FTT noted, however, that HMRC had failed to consider 'special circumstances' (FA 2009 s 55). It observed that the following statement had been inserted in HMRC's statement of case: 'HMRC have considered special reduction but their view is that there are no special circumstances which would allow us to reduce the penalty.' The FTT considered that this was a 'standard form sentence', in the absence of evidence that this question had actually been considered by HMRC.

The FTT stressed that in circumstances where mitigating factors may exist, HMRC ought to make it clear, in its review letter, that those factors have been considered. These may fall short of a reasonable excuse but represent special circumstances.

HMRC's failure to consider special circumstances meant that its decision was 'flawed'. This, in turn meant that the FTT was entitled to vary the penalty because of special circumstances. The FTT considered that HMRC's failure to act on Form 64-8 had been a contributing factor in the taxpayer's failure to file on time and so the penalty should be reduced.

Comments - The penalty was reduced from £100 to £60 but the point of principle is of interest. If HMRC fails to consider special circumstances, the FTT can do so in its place.

Rosie Arnfield v HMRC TC4262

Misled by adviser

Summary –The FTT reduced the penalty in part because of the failure by both HMRC and the taxpayer

The taxpayer's return for 2007/08 was submitted in December 2012, although he was under the impression that his adviser had sent it on time to meet the 31 January 2009 deadline. Under the instruction of the adviser, he paid £250,000 in February 2009 which he believed to be a payment on account, although when the return was made it showed tax due of £395,530. It transpired that HMRC had held the £250,000 as an unallocated payment because the return for the year had not been received at the time the payment was made.

HMRC imposed a penalty at 35% of the late paid tax, against which the taxpayer appealed.

Decision:

The First-tier Tribunal did not accept that the taxpayer's claim that reliance on his adviser accorded him reasonable excuse. Tax return completion did not require the kind of technical advice that could be delegated to the adviser. It was an administrative task for which the taxpayer was responsible, even if he appointed an accountant to carry out the work.

The tribunal decided that the penalty should be reduced to 10%. The taxpayer had genuinely believed he had made a payment on account for 2007/08 and had not realised HMRC had failed to allocate it that way. The appeal was allowed in part.

Comments – This case is a reminder that the ultimate responsibility for a tax return rests with the taxpayer and that responsibility cannot be totally devolved to an advisor.

J Dhariwal v HMRC TC4254

Careless completion

Summary – The taxpayer was clearly guilty of careless completion

In his 2008/09 return, the taxpayer made an error in the tax deducted from employments box in that he included the payments he had made on account as well as the PAYE tax deducted. This led to an apparent overpayment of tax of £469, rather than tax due of £6,623, for the year.

The mistake did not come to light until 2012. HMRC wrote to the taxpayer, saying his 2008/09 return was wrong, and raised a discovery assessment to recover the over repaid tax. They also charged a penalty under FA 2007, Sch 24 on the ground that the taxpayer had made a careless inaccuracy leading to an understatement of tax. The taxpayer appealed.

Decision:

The First-tier Tribunal said the taxpayer, having submitted the form online and examined the tax calculation showing the refund, should have known that it was wrong.

The judge upheld the penalty and dismissed the taxpayer's appeal.

Comments – The judge’s comments were self-explanatory. There is a duty of care on the taxpayer and clearly that had not be applied in the circumstances

A Kolek v HMRC TC4253

Concession on supplies of staff

Summary - The UT found that ELS was not entitled to judicial review.

Education Lecturing Services (ELS) had supplied, as principal, lecturers to colleges of further education. When it had become clear, following the CJEU's decision in *Kennemer* (C-174/00), that it was not an eligible body and could therefore not benefit from the VAT exemption for supplies of education, ELS had restructured its activity so that its subsidiary, Protocol National Ltd (PNL), would make the supplies as agent. Some colleges chose, however, to continue to deal only with ELS.

HMRC ruled that PNL was supplying staff , not education, and that it could take advantage of *Business Brief 10/04*. This provides that employment bureaux which hire out self-employed work-seekers can choose to act as agents, so that VAT is due only on the commission or margin element.

ELS had then contended that it carried on the same business as PNL and was applying for judicial review of HMRC's decision not to allow ELS the benefit of the concession.

Decision:

The UT noted that, where *Brief 10/04* did not apply, the taxpayer must be taxed according to the strict legal position. ELS therefore fell to be taxed as principal, unless and until it chose to be taxed as agent, and there was no evidence of such a choice. Indeed, it was unlikely that the colleges which had remained with ELS understood that it was acting as agent. Additionally, during the relevant period, ELS had submitted its VAT returns on the basis that it was making exempt supplies of education.

Finally, the UT rejected ELS's contention that it should be allowed to apply BB10/04 retrospectively, on the ground that its failure to take advantage of it had arisen from a misdirection of HMRC. The UT quoted Bingham LJ's ruling in *MFK* [1990] 1 WLR 1545, where he criticised the taxpayer for not having 'put all his cards face upwards on the table'. ELS's correspondence to HMRC had originally highlighted the differences between PNL, which was acting as agent, and ELS, which was acting as principal; and HMRC had been entitled to rely on such statements.

Comments - ELS had clearly changed strategy and arguments mid-course. It would, of course, have been preferable for ELS to restructure its business so that both ELS and PNL could avail themselves of the concession. Establishing entitlement to retrospective application of the concession proved impossible.

The Queen on the application of ELS Group v HMRC [2015] UKUT 0048

Inaccuracy penalties and inappropriate forms

Summary - The FTT found that HMRC was not entitled to impose a penalty for filing the wrong form.

The appellants owned property which they decided to convert into two separate flats and planned to sell in the hope of making a profit. They (wrongly) thought that they were entitled to a VAT rebate under the DIY housebuilder's scheme (VATA 1994 s 35) and duly submitted the relevant form (VAT431NB). HMRC contended — and this was accepted — that the appellants were not entitled to make use of the scheme, as they intended to resell the flats. HMRC therefore imposed an inaccuracy penalty (FA 2007 sch 24). It contended that it was the filing of the form itself which constituted the inaccuracy. The appellants argued that there had been no loss to HMRC, as they had subsequently registered for VAT and had correctly recovered input tax.

Decision:

The UT observed that the appellants had responded accurately to each of the form questions and that their claim had been disallowed on that basis. The UT pointed out that HMRC's argument produced the logical absurdity that the appellants' accuracy in completing the form would lead to a penalty for inaccuracy.

Comments - The appellants had misunderstood the purpose of the form and failed to read the accompanying notes. Had they done so, they would have realised that they could not avail themselves of the scheme. Yet the FTT found that no penalty exists for filing the wrong form — provided that it contains accurate statements.

C J Palau & R C Loughran v HMRC [2015] UKFTT 0038

A European conundrum (Lecture P884 – 13.06 minutes)

The Court of Justice of the European Union (CJEU), which is based in Luxembourg, interprets EU law to ensure that it is applied in the same way in all EU countries. It also settles legal disputes between EU Governments and EU institutions. In addition, individuals, companies and organisations can bring cases before the CJEU if they feel that their rights have been infringed by an EU institution.

On 13 November 2014, the CJEU issued its decision in the case of *Commission v UK (C112/14)*, finding that, by maintaining tax legislation concerning the attribution of capital gains to participators in non-UK resident companies, the UK was impeding the free movement of capital.

The judgment considered the rules in S13 TCGA 1992, under which UK-resident participators of a non-UK resident 'close' company can be taxed at the point when the company disposes of an asset and makes a gain. This section was amended by FA 2013, with retroactive effect from 6 April 2012, to include a purpose test and to become less wide-ranging. The recent judgment looks at the section as it stood before the latest amendments, although some of the comments made by the EU judges about the operation of the section may be relevant to the revised position as well.

The CJEU held that the legislation might discourage UK residents from contributing their capital to non-UK resident 'close' companies and impede such companies from attracting UK capital. Consequently, it constituted a restriction on the free movement of capital. Although combating tax evasion and tax avoidance may justify such a restriction, the restriction must not go beyond what is necessary for achieving this end. The CJEU found that the rules prior to the FA 2013 amendments affected real economic activity rather than just wholly artificial arrangements. Furthermore, there was no provision for the taxpayer to provide evidence of the commercial justification of the arrangements in question. As such, the CJEU found that the previous version of S13 TCGA 1992 went beyond what was necessary for achieving its objective.

This ruling offers individuals and trusts who have paid tax under S13 TCGA 1992 with an opportunity to review their position (under whichever version of S13 TCGA 1992 the CGT was paid). If they are still in time, taxpayers should consider seeking to reclaim the amounts which they have paid.

Contributed by Robert Jamieson

Penalties for tax return errors involving losses (Lecture P885 – 11.13 minutes)

Background

The penalty provisions for errors in tax returns etc (FA 2007, Sch 24) potentially apply where the return contains certain kinds of inaccuracy that are careless or deliberate.

An 'inaccuracy' for these purposes not only applies to an understated tax liability, but also includes "a false or inflated statement of a loss" (FA 2007, Sch 24, para 2(b)).

How are penalties charged in respect of an overstated loss?

Penalties for incorrect losses

The calculation of a penalty for an inaccuracy in the tax return is subject to a number of factors, such as the underlying behaviour that gave rise to the error, whether the disclosure was prompted or unprompted, and the quality of disclosure. A key element in the calculation is the 'potential lost revenue'; a percentage is broadly applied to it in arriving at the amount of the penalty.

The normal rule is that the potential lost revenue in respect of (say) a tax return error is the additional tax due and payable as a result of correcting the error. This includes amounts payable to HMRC due to excessive tax repayments (FA 2007, Sch 24, para 5).

However, in the case of losses, the penalty legislation provides as follows (FA 2007, Sch 24, para 7(2)):

> *"(2) Where an inaccuracy has the result that a loss is wrongly recorded for purposes of direct tax and the loss has not been wholly used to reduce the amount due or payable in respect of tax, the potential lost revenue is—*
>
> *(a) the potential lost revenue calculated in accordance with paragraph 5 in respect of any part of the loss that has been used to reduce the amount due or payable in respect of tax, plus*
>
> *(b) 10% of any part that has not."*

Thus penalties can be charged for tax return errors even though no tax was immediately at stake and the loss cannot be utilised straight away.

Escape route

However, in the case of unused losses, the penalty legislation provides a potential let-out from a penalty in certain circumstances (Sch 24, para 7(5)):

> *"(5) The potential lost revenue in respect of a loss is nil where, because of the nature of the loss or P's circumstances, there is* ***no reasonable prospect of the loss being used*** *to support a claim to reduce a tax liability (of any person)"* (emphasis added).

This ‘no reasonable prospect’ exception to the normal rule was considered (among other things) in the recent case *Elsina Ltd v Revenue & Customs* [2015] UKFTT 14 (TC).

In that case, HMRC opened an enquiry into the appellant company’s corporation tax return for the accounting period ended 31 May 2010. It transpired that dividend income of over £3 million, which was excluded from the company's taxable income, was taxable (by virtue of CTA 2009, s 931W). Following an enquiry into the company's accounting period ended 31 May 2011, it was also accepted that dividend income of almost £900,000 was similarly taxable.

The effect of the company omitting the dividend income from its computation of trading income was to inflate the amount of loss for the 2010 accounting period, and to understate the taxable trading profit for the 2011 accounting period, against which trading losses brought forward were set. The company had substantial carried forward losses at the end of both periods. HMRC imposed penalties on the company in respect of the 2010 and 2011 accounting periods. The company appealed.

The First-tier Tribunal found that the company’s adviser who prepared the returns had not taken reasonable care. The company had delegated the preparation of its returns to the adviser. The tribunal was satisfied that a taxpayer cannot “hide behind” an adviser who has not exercised the appropriate level of care. The error was careless.

No ‘reasonable prospect’?

The company argued that the potential lost revenue by reference to which the penalties were calculated by HMRC was nil (as opposed to 10 per cent of the relevant losses), on the basis that there was no reasonable prospect of the loss being used to support a claim to reduce a tax liability.

Unfortunately, from the evidence provided the tribunal was unable to arrive at a finding that there was no reasonable prospect of the losses being used to support a claim to reduce a tax liability. The company's appeal against HMRC's decision to impose penalties (and also its decision not to suspend the penalties) was dismissed.

HMRC’s guidance (at CH82370) instructs its officers to use a two step process in deciding whether there is a reasonable prospect of any part of a taxpayer’s loss being used. Step one requires the HMRC officer to ask whether, in the current circumstances, there is a “legal or factual reason” why the loss cannot ever be used. If the answer is ‘no’, step two requires the officer to assess the taxpayer’s future circumstances, and ask if there is a reasonable prospect of the loss being used.

HMRC officers are instructed to invite representations from taxpayers who consider that future circumstances are such that there is no reasonable prospect of the loss being used. Examples of the ’no reasonable prospect’ test are given in HMRC’s guidance (at CH82371).

In *Elsina Ltd*, the tribunal noted that evidence to support the company's contention that there was no reasonable prospect of the company's losses being used was “very limited”. Nevertheless, this possible let-out from a penalty may be helpful in other cases. However, note that there must be no reasonable prospect of the losses being used by “any person”. This condition may make claims that FA 2007, Sch 24, para 7(5) applies more difficult in a group context.

HMRC Penalties: a Discussion Document

HMRC issued a discussion document on 2 February 2015 with a closing date for comments of 11 May 2015 on how penalties might be changed.

The document commences by setting out HMRC's approach to compliance, the role of penalties and concerns about current penalties. The key aspects to consider are the potential changes that HMRC might initiate.

"How we might change penalties

In future, we want to make greater use of behavioural and customer understanding, and use our digital capability to communicate with our customers in a more targeted and individualised way. Our digital delivery will increasingly be based around the whole customer and not based around specific tax regimes. And so we want to consider if our penalties could also be applied in a more sophisticated and customer-focused way.

We've started to think about how we might update the way in which we administer penalties and some of our early thoughts are below. We would like to hear what our customers and stakeholders think and any other ideas or comments they may have.

The role of penalties

Our current thinking is based around five principles. They are:

1. The penalty regime should be designed from the customer perspective, primarily to encourage compliance and prevent non-compliance. Penalties are not to be applied with the objective of raising revenues
2. Penalties should be proportionate to the offence and may take into account past behaviour
3. Penalties must be applied fairly, ensuring that compliant customers are (and are seen to be) in a better position than the non-compliant
4. Penalties must provide a credible threat. If there is a penalty, we must have the operational capability and capacity to raise it accurately, and if we raise it, we must be able to collect it in a cost-efficient manner
5. Customers should see a consistent and standardised approach. Variations will be those necessary to take into account customer behaviours and particular taxes.

Possible implications for penalties

We need to consider:

- whether penalties should be applied for an uncharacteristic failure by an otherwise compliant customer
- our response to those who make a simple mistake when entering a particular tax regime for the first time, or those who need extra help
- whether a customer's compliance with each of their obligations should be considered separately, or whether penalties should take account of their behaviour as a whole.

One option could be using non-financial sanctions as an alternative to financial penalties. We also want to find a way to reduce or remove the risk of our most vulnerable customers receiving penalties, while still helping them to meet any tax obligations.

We currently impose a large number of low-value penalties in Income Tax Self Assessment and expect to do the same in the Real Time Information PAYE regime (known as 'RTI'). We want to consider moving to a different model.

One option could be a progressive system similar to penalty points for motoring offences, so that initial financial penalties are avoided, but more substantial penalties then apply for more serious failures or for persistent non-compliance with obligations. There may be advantages in not initially applying penalties, but the downside might be that customers fail to realise the importance of non-compliant behaviour. The role of our digital communications would then be key in ensuring there are no surprises for customers.

If a customer has a personalised digital tax account showing all the taxes they need to pay in one place, we may need to move away from applying penalties on a tax-by-tax basis, and towards a penalty system that is based on the overall position of the customer. This might mean there are implications for the role of interest.

Penalties only arise where customers don't meet the obligations that are set. In the light of our developing approach to compliance and the greater availability of data and digital tools, we'll also need to look closely at some of these obligations.

Any changes to HMRC's penalty regimes would follow the usual policy development process and need primary and secondary legislative changes. As part of that process, we would follow the tax impact assessment process, and build a good understanding of the possible impact on our customers – businesses and individuals – the Exchequer and HMRC. Also any changes made would need to take account of, and be dependent on, HMRC's developing IT capability. "

HMRC News

Employers will not incur penalties for delays of up to three days in filing PAYE information, HM Revenue and Customs (HMRC) announced

Late payment penalties will continue to be reviewed on a risk-assessed basis rather than be issued automatically.

There is no change to the filing deadlines. This means filing on or before each payment date unless the circumstances set out in the sending an FPS after payday guidance apply.

In addition, to prevent the unnecessary penalties being issued, HMRC will be closing around 15,000 PAYE schemes next month that have not made a PAYE report since April 2013 and which appear to have ceased.

HMRC will write to the affected schemes to tell them about the planned closure and what to do if they are, or should be, operating PAYE.

Employers with fewer than 50 employees are reminded that PAYE late filing penalties will apply to them from 6 March.

HMRC has published a discussion document seeking views by 11 May about potential improvements to the way in which penalties apply for failing to pay what is owed or to meet deadlines for returns or registration.

HMRC is considering whether, and if so, how it should differentiate between those who deliberately and persistently fail to meet statutory deadlines or to pay what they should on time, and those who make occasional and genuine errors for which other responses might be more appropriate.

Following the consultation, HMRC will review the operation of the changes to the PAYE penalties by 5 April 2016

Any employer that has received an in-year late filing penalty for the period 6 October 2014 to 5 January 2015 and was 3 days late or less, should appeal online by completing the “Other” box and add “Return filed within 3 days”.

End of year reporting

Employers are no longer required to complete the final report checklist items 111 to 117 on their last full payment submission (FPS) or employer payment summary (EPS) for a tax year. This change takes effect for PAYE reports made from 6 March 2015.

As a result, from 6 March 2015 HMRC will accept a final FPS or EPS for a period from 6 April 2014 to 5 April 2016 with or without a completed checklist. Employers that have to complete the checklist because their soft ware providers have been unable to change their products in time, must ensure it is completed accurately.

The Revenue will remove these checklist items from the basic PAYE tools as soon as possible but probably not until July 2015.

The following are some reminders for final 2014/15 submissions:

- the final FPS should be sent on or before the last pay day of the tax year;
- the final FPS or EPS should indicate that it is the "Final submission for the tax year" for the whole PAYE scheme; and
- the employer can make an EPS final submission if the FPS did not state it was the final one, no one was paid in the final pay period of the year, or the final submission was filed early and the employer did not pay anyone for one or more full tax months for the rest of the tax year.

If any of the information on the final submission needs to be corrected, a revised FPS must be sent before 20 April 2015, indicating that it is the final submission for the tax year. Any errors in the final FPS discovered on or after that date should be corrected by sending an earlier year update (EYU).

Employers have until 31 May 2015 to give a P60 end of year certificate to employees.

Business Taxation

Total eclipse of relief

Summary – The taxpayer partnership has lost their appeal at the Court of Appeal

In April 2007, the taxpayer partnership obtained a 20-year licence from Disney to distribute two films. The business was financed by 289 partners, who contributed £840m. They borrowed £790m and claimed tax relief on the interest under TA 1988, s 362(1)(b) on the basis that the partnership was carrying out a trade and the loan constituted capital used wholly for the purposes of the trade.

HMRC refused the claim on the basis that the taxpayer was not carrying on a trade. The First-tier Tribunal and Upper Tribunal dismissed the taxpayer's appeal. They ruled that the partnership had carried on a "non-trade business" of film exploitation of ITTOIA 2005, s 609. The taxpayer appealed.

Decision:

The chancellor of the High Court, Sir Terence Etherton, delivered the Court of Appeal's judgment. He said "the proper characterisation" of the taxpayer's business depended on the totality of its activity and enterprise. The payment of the licence fee had the character of an investment. The possibility that the partnership would obtain a share in the contingent receipts was not sufficient, in the context of the business as a whole, to characterise its business as a trade.

The First-tier Tribunal's conclusion that the partnership had not in reality been carrying on a trade was correct. The taxpayer had not shown that it had been engaged in trade in any realistic way.

It was established law that the production and exploitation of a film was a trading activity but, in this instance, the taxpayer had not paid for the production of the films, nor had it made a significant contribution towards their exploitation.

The taxpayer's appeal was dismissed.

Comments - Michael Avient, partner at UHY Hacker Young, said the decision "leaves no doubt that where a tax avoidance scheme is found not to be trading by the lower courts, on appeal this will only be overturned in exceptional circumstances". He added that the participants in *Eclipse* "not only failed to reduce their tax bill but now face catastrophically larger tax liabilities than if they had never participated in it".

He believes the decision has wide implications: "One of the challenges facing many of the marketed tax schemes either awaiting litigation or appeal is whether they are carrying on a trade and, as such, rely on obtaining income tax relief from losses generated from such a trade. A common thread in many of the 'trading' tax avoidance structures identified by HMRC is that the partnership, limited liability partnership, individual or company undertook minimal activity other than a supervisory role with little or no actual control. As identified by the courts in *Eclipse 35*, if this is linked by only a remote prospect of generating a profit then the most likely outcome on the finding of fact is that there was not a trade."

He concluded: “The seed of the scheme's ultimate failure was buried deep in the detail of long and complex contracts and it is unlikely that investors or their advisers would have had access to these documents. As with many tax avoidance structures, both the investor and adviser need to rely on those implementing the structure to get things right.”

Eclipse Film Partners No 35 LLP v CRC, Court of Appeal

Reclassification of dividends to salary (Lecture B882 – 8.36 minutes)

The recent case of Richard and Julie Jones details the First Tier Tribunal’s opinion on the required procedures for low salary, high dividend and the implications of reclassifying these dividends as salary if it later transpired that the dividends were unlawful.

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

Mr and Mrs Jones were reviewing their monthly accounts with their accountant before quantifying the dividend for the following month. Once they were satisfied that there were sufficient profits available an interim dividend was declared and paid.

The company got into trading difficulties and they were advised that the liquidator might regard the dividends as unlawful. As a result, their director’s loan accounts would be significantly overdrawn and the liquidator would seek repayment of the overdrawn loan account. In order to avoid this possibility they were advised to reclassify their dividends as salary.

When the payments were reclassified as salary, HMRC sought to establish wilful failure to deduct tax and NICs and attempted to recover the PAYE and National Insurance amounts from Mr and Mrs Jones personally under the Income Tax (PAYE) Regulations, SI 2003/2682, reg 72 and the Social Security (Contributions) Regulations, SI 2001/1004, reg 86.

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

Decision:

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

Had the dividends been unlawful you would have applied the “wilful failure” test at the point of reclassification.

It is quite likely that the PAYE and National Insurance would have been a personal liability of Mr and Mrs Jones had the dividends been unlawful and then later reclassified as salary. At the point of reclassification it was reasonably clear that the company was in difficulty and the PAYE and National Insurance would not be paid over.

Richard and Julie Jones v HMRC [2014] UKFTT 1082

Reclaiming section 455 CTA 2010 Tax – The New Procedures

Query - Back in 2011 I borrowed some money from my company, and paid the corporation tax charge due. Business has now improved. Therefore my company can now pay a dividend to clear the debt I owe to the company. How can I reclaim the corporation tax charged?

Answer - You need to complete a form L2P to reclaim that tax charge, but that must be done online here: www.gov.uk/government/publications/corporation-tax-reclaim-tax-paid-by-close-companies-on-loans-to-participators-l2p.

You need to answer all the questions on the interactive form, then print it off and sign it. The signed form should be sent to:

HMRC
Corporation Tax Services
PO Box 29997
Glasgow, G70 5AB

This simple query is a useful intro into an area that many practitioners are familiar with but we always need to keep abreast of this area.

A s.455 CTA 2010 tax charge arises, subject to a couple of exceptions, where a close company makes a loan or advances money, for example, an overdrawn director's loan account, to an individual participator or their associate, e.g. spouse, partner, parent, grandparent, child, grandchild, sibling, trust.

The exceptions are loans made in the ordinary course of the Company's business and loans not exceeding £15,000 in total, made to directors or employees working full time for the Company (or an associated company) who do not have a material interest (>5%) in the Company

The s.455 CTA 2010 charge arises strictly on overdrawn loans at the year-end date but provided the overdrawn amount is cleared (by repayment or release) within nine months of the year end, no s.455 tax is payable (by virtue of s.458 CTA 2010) .

The tax charge is 25% of the lower of the amount outstanding at the end of the accounting period and on the CT payment date (nine months and a day after the accounting period) and is payable at the same time as the CT.

The anti-avoidance provisions introduced by FA2013 as s464C CTA 2010 needs to be remembered.

S464C CTA 2010 renders any loan repayment ineffective where either:

1. within a 30-day period, the client makes repayments of their s.455 loan of at least £5,000 and in a subsequent accounting period new loans or advances of at least £5,000 are made to the same shareholder or their associate; or

2. the outstanding loan is at least £15,000 and there are arrangements in place for new loans of at least £5,000 to be issued at any time to replace some or all of the amount repaid.

Making a reclaim

In the past, there was no set format for communicating with HMRC to reclaim the s.455 tax. This changed on 4 December 2014 when HMRC issued a new form, L2P , which should now be used to reclaim the s.455 tax.

The L2P is one of HMRC's on-screen forms and therefore this means you will need to complete the form fully before you can print it and you can't save a partly completed form so you'll need to ensure you gather all the information together first. The required information is:

1. Company name
2. Company UTR
3. Date of current accounting period
4. Date of accounting period in which the loan was made
5. Date loan made
6. Date loan/part of loan released, repaid or written off
7. Value of loan/part of loan released, repaid or written off
8. Signature.

Send the form nine months and one day after the end of the accounting period of repayment so you will need to make a diary note to remind you to file the L2P on the correct date.

Finally don't forget the time limit - S.455 tax can be reclaimed regardless of how long ago it was paid. However, the time limit for making the claim is four years from the end of the accounting period in which the loan is repaid or written off.

Contributed by Tony Jenkins

CFC and dividend group litigation: outstanding issues

Summary - The High Court covered additional points that were not addressed in its main judgment delivered on 24 October 2014.

The issues related to liability and quantification. They arose from the potential invalidity under EU law of the UK legislation that governed the taxation of 'portfolio dividends' (dividends derived from holdings of less than 10% of the shares in the companies concerned) paid by non-resident companies to companies resident in the UK. The Prudential Assurance Company is a test claimant in a group litigation.

Decision:

The High Court confirmed that a claim relating to lawfully incurred ACT utilised against an unlawful corporation tax liability 'is a claim in restitution for the repayment of unlawfully levied tax in the form of ACT', which can only be pursued in the High Court. The court added that HMRC is not entitled to contend that the ICTA 1988 s 231 credits generated on EU income could only be applied to reduce an ACT charge, to the extent that EU income could be said to have been distributed so as to incur an ACT liability. This is because it would be inconsistent with the rulings on the nature and quantification of the s 231 credit required by EU law which were given in the main judgment. Finally, where an undifferentiated fund of lawful and unlawful ACT was utilised by being set off against an amount of mainstream corporation tax (MCT), which was itself in part lawful and in part unlawful, a pro-rata approach would lead to anomalies. Therefore, the unlawful ACT should be regarded as having been utilised first against the unlawful MCT, as suggested by Prudential.

Comments - This judgment resolves some outstanding questions of principle following the main judgment delivered on 24 October 2014.

The Prudential Assurance Company v HMRC [2015] EWHC 118

The UK legislation on cross-border group relief and EU law

Summary - The CJEU found that the UK legislation on cross-border group relief complies with EU law principles.

The European Commission was applying for a declaration by the CJEU that CTA 2010 s 119(4) makes it virtually impossible in practice to obtain cross-border group relief, so that the UK has failed to fulfil its obligations under TFEU arts 31 and 49.

Cross-border group relief is only available if the 'no possibilities test' is satisfied; that is, if the losses are not relievable in the country where the loss-making subsidiary is established. Under CTA 2010 s 119(4), the determination as to whether losses may be taken into account in the future must be made 'as at the time immediately After the end' of the accounting period in which the losses were sustained. According to the Commission, cross-border relief can therefore only be available if either carry forward of losses is not possible under the legislation of the country of residence of the subsidiary; or if the subsidiary is liquidated at that time.

Decision:

However, the CJEU observed that the first situation mentioned by the Commission was irrelevant for the purpose of assessing the proportionality of s 119(4). In such a situation, the member state in which the parent company is resident may not allow cross-border group relief without thereby infringing art 49 (*K* (C-322/11)). As for the second situation, the CJEU considered that s 119(4) does not require the subsidiary to be put into liquidation before the end of the accounting period in which the losses were sustained. The provision only imposes a requirement to make an 'assessment' at that time.

The Commission also submitted that the UK was in breach of TFEU arts 49 and 31 in that its legislation precludes cross-border group relief for losses sustained before 1 April 2006. The CJEU found, however, that the Commission had not established the existence of situations in which cross-border group relief for losses sustained before 1 April 2006 was not granted.

The CJEU therefore rejected both complaints.

Comments - By confirming that the UK legislation on cross-border group relief is now compliant with the EU law principles of freedom of establishment and of movement of capital, the CJEU's decision may have come as a disappointment to some international groups.

Rupert Shiers (Hogan Lovells) commented: 'If "no possibilities" is assessed immediately After the end of the accounting period, under current legislation there will be few valid claims. But the CJEU decision is only that the Commission failed to prove its case. And there is tension to resolve with the Supreme Court decision in Marks and Spencer [2013] UKSC 30, that for pre-April 2006 losses "no possibilities" is assessed at the date of claim.'

European Commission v UK (C-172/13)

Tax differentials and state aid

Summary - The CJEU found that the Commission had rightly found that tax rate differentials amounted to state aid.

In March 2009, Ireland introduced air travel tax (ATT), which was charged directly to airline operators. In July 2012, the Commission found that state aid, which took the form of a lower ATT rate of €2, was incompatible with the internal market. This lower rate was applicable to all flights operated by an aircraft capable of carrying more than 20 passengers departing from an airport with more than 10,000 passengers per year to a destination no more than 300 km from Dublin airport. This was an application to annul the key parts of the Commission's decision. The CJEU observed that the concept of aid is more general than that of subsidy and includes measures which are similar in character and have the same effect. The only question was whether the measure was such as to favour certain undertakings.

Decision:

The CJEU rejected contentions that the higher standard rate of €10, used as reference by the Commission, had been found unlawful in *Stylianakis* (C-92/01); it was the application of that rate in conjunction with a lower rate which had been found unlawful. The CJEU also found that the Commission had been right not to base its analysis on hypothetical reimbursement rights. Finally, the fact that the lower rate and the standard rate had been introduced by the same legislation did not affect the analysis.

The CJEU found, however, that the Commission had been wrong to order the recovery of the aid, evaluated at €8 per passenger, from the airlines which had operated flights subject to the ATT at the lower rate of €2 during the period concerned, as the operators may have passed the economic advantage to passengers.

Comments - The case confirms that a differential between two tax rates can constitute state aid. Interestingly, the quantum of such aid, and the amounts which must be reimbursed, may depend on whether the advantage has been kept by economic operators or passed on to their customers.

Ryanair v European Commission (T-500/12)

Ascertaining undeclared income

Summary - The FTT agreed with HMRC's method of ascertaining undeclared income over several years.

Mr Mirsamadi was appealing against discovery assessments in respect of the years 2004/05, 2005/06 and 2006/07, as well as closure notices for years 2007/08, 2008/09, 2010/11 and 2011/12.

HMRC had opened an enquiry into the 2007/08 tax year. Bank details showed unidentified deposits and that a property had been sold, but no capital gains tax had been paid. In April 2013, HMRC calculated that there was a shortfall in the income which the appellant would have needed to maintain himself, his two young children and his wife. Given the lack of information provided by Mr Mirsamadi, HMRC had used the Office of National Statistics' Living Cost and Food Survey to calculate the family's expenditure. The calculation was based on the premise that the expenditure of Mr Mirsamadi on food and fuel was in the lowest 20% in the country. The figures for actual expenditure were used on other items, such as mortgage, council tax, flights, insurance, Sky contract, private school fees and gym membership. The calculation resulted in expenditure exceeding known income by £41,753. The retail price index was used to calculate how much the appellant needed to live in earlier years and the resulting shortfalls of declared taxable income.

Decision:

The FTT found that the method used by HMRC had been reasonable and that the onus had rested with Mr Mirsamadi to provide more accurate figures. He had not done so. Furthermore, the penalties had been justified, given that the behaviour of Mr Mirsamadi had been both deliberate and concealed.

Comments - This case sets out the way HMRC will estimate a taxpayer's income in the absence of information provided by him. Such methods, which were judged reasonable by the FTT, include estimating a year's income and then extrapolating the income of previous years.

Masoud Mirsamadi v HMRC [2015] UKFTT 0058

Low emission cars – buy ASAP to qualify

As many people know, cars don't qualify for the annual investment allowance. However, for a number of years, it has been possible to claim a 100% first year allowance (FYA) on cars with low CO_2 emissions. This tax relief was originally due to finish on 31 March 2015 but on 17 February 2015 new legislation came into force to extend the 100% FYA until 31 March 2018.

Unfortunately the new law also lowers the CO_2 emissions limit from 95g/km to 75g/km for cars bought on or after 1 April 2015.

If clients are looking to purchase a low emission car to take advantage of the 100% FYA, they will have a much wider choice if they can purchase by 31 March 2015 because of the higher threshold. They may therefore need to consider bringing forward the expenditure.

Most car manufacturers offer a number of petrol and diesel models under the 95g/km limit. Examples of such cars include the Volkswagen Golf 5 door BlueMotion 110PS manual option (85 g/km) and Mercedes Benz C Class saloon Executive 7G-tronic automatic option (94 g/km).

There are very few petrol and diesel models under the new 75 g/km limit.

VAT

Getting to grips with the option to tax forms (Lecture B885 – 15.30 minutes)

A tricky subject in the world of VAT is the option to tax in relation to property matters. We have a range of forms in the VAT1614 series which need to be completed by owners and buyers during the course of various property deals. I often find that advisers get confused dealing with the different forms so we will look at some practical examples of when the various forms need to be used.

Commercial building converted to dwellings

Example 1

John owns a factory and he has an option to tax election in place on the building. In other words, income generated by John from the property (rental income or selling proceeds) is subject to 20% VAT in most cases. John has received an offer from Mike to buy the freehold of the factory and Mike intends to convert it into 10 luxury flats. In this situation, Mike can avoid paying 20% VAT on the purchase of the building by presenting John with HMRC's form **VAT1614D** to confirm his intention to convert the property into 'dwellings'. In such cases, the standard rated property sale by John (because of his option to tax election) becomes exempt from VAT again i.e. the option to tax is overridden. The form is not sent to HMRC but retained by both parties in the event of a sale taking place. The declaration made by Mike is effectively that he:

- intends to use the building as a dwelling or for a relevant residential purpose; or
- intends to convert the building into a dwelling or relevant residential building with a view to it being used as a dwelling or for a relevant residential purpose

Examples of 'relevant residential buildings' include student accommodation, elderly persons home etc.

This project should have no problem meeting the definition of a "dwelling" which can be found within Note 2 of Schedule 8 Group 5. Essentially a building is designed as a "dwelling or number of dwellings" where the building contains a dwelling or more than one dwelling and in relation to each dwelling the following conditions are satisfied:

- it must consist of self-contained living accommodation;
- the separate use of the dwelling is not prohibited by the terms of any covenant, statutory planning consent or similar provision;
- the separate disposal of the dwelling is not prohibited by the terms of any covenant, statutory planning consent or similar provision; and
- statutory planning consent has been granted in respect of that dwelling and its construction or conversion has been carried out in accordance with that consent.

Demolish a building and sell land

Imagine the following situation: John has decided to demolish the factory and sell bare land to Mike – and then Mike will build new purpose built flats rather than convert the existing building. Mike again gives form VAT1614D to John.....but is this correct? The answer is 'no' – the form is only used in connection with buildings and not land.

But what if the land was sold to a housing association instead of to Mike? A housing association that intends to build new dwellings on land can issue form **VAT1614G** to override the option to tax election of the seller. This means that John's land sale will be exempt from VAT, an excellent outcome for all parties, again assuming that John has no capital goods scheme issues to consider.

Option to tax in place more than 20 years

Unfortunately for John, he has still not sold his land. But there is a new window of opportunity in relation to VAT ie he is able to reverse his option to tax election with HMRC if it was made more than 20 years ago.

The option to tax regulations were introduced on 1 August 1989, so there has been scope to reverse some options since 1 August 2009. A business must send form **VAT1614J** to HMRC's option to tax unit in Glasgow.

Note – forms VAT1614D and VAT1614G considered earlier were not submitted to HMRC (but must be available for inspection in the event of a routine visit or enquiry to review the records of the property seller) but VAT1614J must be sent to them as a requirement.

As a comment about revoking the option to tax, there are five questions that need to be considered by taxpayers before they can sign form VAT1614J. These questions are for anti-avoidance purposes to prevent e.g. a property owner trying to prepay a major expense just before reversing his option to tax election so that he gets input tax recovery on the expense – when the reality is that it will be relevant to a period when the property is being used for future exempt supplies – see Example 2.

Example 2

Susan rents out a property she owns to a firm of insurance brokers – the latter business cannot reclaim input tax on its expenditure (because it is making exempt supplies of insurance) so Susan agrees to reverse her option to tax election with HMRC once it has been in place for 20 years. However, on the final day before she reverses the option, she pays a maintenance company £50,000 plus VAT to cover the maintenance costs on the property for the next five years i.e. a prepaid expense relevant to a five year period when her rental income from the property will be VAT exempt. There is no problem with Susan agreeing the contract and prepaying the expense but she will need to confirm to HMRC that no input tax will be reclaimed on this expense otherwise she will not be able to revoke her option to tax election.

Note – there is a second opportunity to reverse an option – if the business/person has held no interest in the land or building in the previous six years. The revocation is automatic and no notification is needed. HMRC Notice 742A, para 8.2.

Constructing a new building on opted land

Going back to John, the final twist to the tale is that he couldn't sell his land to either Mike, the housing association or any other party, so he has decided to build an office block on the land and rent it out for three years, and then sell it after three years, almost certainly to a bank or other financial institution. Here are the key VAT facts:

- An option to tax election is always made on land, and then it applies to any building that is constructed on the land but excluding residential properties.
- So a new office block built on opted land is automatically covered by the option to tax election made on the land where the previous building (John's factory) was located
- The only way of avoiding this outcome is if John completes form **VAT1614F** to specifically exclude the new factory from the original option to tax election.

Note –John might want to take advantage of the VAT1614F opportunity to avoid charging VAT on both the rent and future sale of the freehold to his tenant/buyer (although he would sacrifice input tax recovery on his construction costs). However, note that I deliberately said that he would not sell the property until it was three years old – this is because the freehold sale of a 'new' commercial building is standard rated by statute, irrespective of any option to tax election that might be in place. And a building is classed as 'new' until it is three years old, which usually means three years after the date of the completion certificate issued by an architect or other professional person. Once a commercial property is more than three years old, the sale is exempt from VAT unless the seller has opted to tax the property either by completing form **VAT1614A** or, in some cases where HMRC permission is required, form **VAT1614H.**

Five other forms

- If you are making land and property supplies, then form **VAT5L** gives taxpayers the chance to tell HMRC about the specific nature of the supplies in question, together with the VAT liability of those supplies, at the time a business is seeking to register for VAT. HMRC will then be able to verify that a business is making some taxable supplies and is therefore entitled to register for VAT.
- **VAT1614B** – Ceasing to be a relevant associate in relation to an option to tax
- **VAT1614C** – Revoking an option to tax: six month cooling off period
- **VAT1614E** – Notification of a real estate election – HMRC Notice 742A, section 14.

VAT status of booking fees

Summary - The UT found that a booking fee was charged for a 'payment card processing service'.

The issue was the VAT treatment of booking fees charged by the National Exhibition Centre (NEC). The NEC owns several venues which it hires out to promoters, which stage trade, cultural and entertainment events. Through its own box office, the NEC sells tickets to those events. It derives its income from various fees, including a 10% booking fee generally charged to customers paying by credit card.

Under VATA 1994 Sch 9 Group 5 item 1, transactions involving the handling of money are exempt from VAT. The FTT had found that the booking fee was paid for a 'payment card processing service' (the 'supply issue'), exempt from VAT (the 'exemption issue'). The supply issue was a factual issue. The finding of the FTT could therefore only be displaced if the FTT had not, as a matter of law, been entitled to reach this conclusion. Referring to the court of session's decision in *SEC* [2008] STC 967, the UT noted that it was not formally bound by it, but that it should nevertheless follow it. Following *SEC*, the UT observed that the service should be considered objectively from the viewpoint of the typical customer, focusing in particular on the circumstances when a booking fee was and was not charged. The conclusion reached by the FTT that the booking fee was paid for card processing services was therefore open to it.

Decision:

The UT also observed that the fact that the fees had not been described as 'card processing services' was irrelevant; so was the fact that the booking fee bore no correlation to the cost of the service to the NEC. The UT thus concluded that the FTT had correctly identified the supply, but that the exemption issue should be referred to the CJEU.

Comments - The line between taxable services (such as the provision of financial information) and exempt services (such as data handling services) remains dangerously blurred. This is also evidenced in *Bookit* [2014] UKFTT 856, which turned on similar issues. The CJEU's decision will hopefully bring some much needed clarification.

HMRC v National Exhibition Centre [2015] UKUT 0023

New building or extension?

Summary - The UT found that Astral had erected a new building.

Astral had built a nursing home incorporating a redundant church. It contended that the construction services were zero-rated supplies for the construction of a building designed for use for a relevant residential purpose (VATA 1994 sch 8 group 5 item 2). HMRC however considered that Astral had only extended the building so that the works were standard rated. Astral had purchased a site, including a church, a presbytery and several outbuildings. It had obtained permission for the building of a care home and the demolition of all the buildings except for the church (which was to be used for a purpose ancillary to the residential care home). The original church building formed the main entrance and reception area for the nursing home; it also included a new mezzanine floor. After the works, the floor area of the original church, including the mezzanine floor, was 455 square metres. The floor area of the new parts was 2,910 square metres.

Decision:

The UT rejected HMRC's contention that only the erection of a new building 'as a whole' amounted to the construction of a building. Agreeing with the FTT (and applying *Marchday Holdings* [1997] STC 272), the UT observed that 'the question of whether the construction of a new building or buildings connected to the church was an enlargement or extension to the church is a question of fact, degree and impression'. The UT found that the work constituted the construction of a building.

Finally, the UT found that if the works had not amounted to the construction of a new building, they would have constituted a special residential conversion, subject to a reduced rate (VATA 1994 Sch 7A Group 6), as After the conversion, the converted premises (the church) formed the entirety of the nursing home.

Comments - The case confirms that the answer to the question of whether a new building has been built (rather than an existing building extended) is very much a question of fact and degree. The fact that the original building represented less than a sixth of the new building was a key factor in favour of the taxpayer.

HMRC v Astral [2015] UKUT 0021

Single or mixed supply?

Summary – The Tribunal determined that there was a mixed supply

The taxpayer, the Church of Scientology Religious Education Inc (CSR), an Australian charity registered for VAT in the UK, made exempt supplies of education, as well as some taxable ones. Courses were prepared by the Church of Scientology International (CSI), a Californian charity, and supplied to the taxpayer under a contract known as the ecclesiastical services agreement.

A question arose as to the nature of the services supplied. Before 1 January 2010, they were outside the scope of VAT, but after that date they were treated as being supplied in the UK. As such, to the extent that they were standard-rated, the taxpayer had to account for them under the reverse charge. Because the taxpayer was partially exempt, it would be unable to recover all the VAT.

The matter proceeded to the First-tier Tribunal. The taxpayer considered there was a single supply by CSI of educational services that were exempt under VATA 1994, Sch 9 group 6. HMRC claimed there was a standard-rated single “supply of overall governance and specific assistance for churches and/or giving ecclesiastical direction to all churches of scientology worldwide, seeing the orthodoxy of the scientology religion is maintained and providing worldwide ecclesiastical management of the church as a whole”.

Decision:

The tribunal judge said the key challenge was to consider the economic reality of the supplies, rather than just applying a general label of “ecclesiastical services”. He concluded that the services were "diverse in character". Some were directly related to the provision of education, but others related to governance and control by the CSI. He disagreed with the taxpayer that education was the dominant supply and the rest ancillary. "Viewed objectively" the supplies were equal, he said.

According to the tribunal, there was a mixed supply. The case was adjourned to allow the parties to agree on the apportionment between exempt and standard-rated supplies.

Comments - Neil Warren, independent VAT consultant, said: "This is an unusual case in that the tribunal opted for a different outcome from that proposed by HMRC and the taxpayer, in that it decided there was a mixed rather than single supply. There was a strong emphasis on looking at the substance of the supplies from the point of view of the consumer rather than the contractual position. This is a common approach in cases of this nature and a useful point to bear in mind when faced with similar challenges."

Church of Scientology Religious Education College Inc v HMRC TC4157

Whether provision of breakdown cover was a supply of insurance

Summary - The advocate general (AG) considered that the provision of car breakdown cover was an insurance service exempt from VAT.

Mapfre charged second-hand car dealers a fixed sum and agreed to meet the cost of repairing the vehicles if they broke down during a specified period. It treated the charges to the dealers as subject to VAT. The French tax authority viewed the supplies made by Mapfre as VAT exempt supplies of insurance.

Decision:

The AG noted that the Sixth Directive does not define 'insurance'; however, it had been defined by the CJEU in particular in *BGZ Leasing* (C-224/11). That definition was sufficiently wide to cover services by a trader which is not an insurer, but which provides cover to its clients under a collective insurance provided by an insurance company. Furthermore, it was irrelevant whether the vendor of the car purchased the insurance as principal or as agent for the buyer of the car.

Finally, the AG distinguished the provision of insurance from the provision of a warranty by the vendor of a car; in the provision of warranty, the vendor represents that the car will not break down and commits himself to repair it in the unlikely event that it does so. The provider of such a warranty has full control of the risk and of the costs of repair. This is not the case for an insurer.

Comments - It remains to be seen whether the CJEU will follow this opinion, and in particular the distinction drawn by the AG between warranty and insurance. If it does, other providers of similar services — which may be labelled as warranties — may wish to avail themselves of the insurance exemption.

Directeur Général des Finances Publiques v Mapfre Warranty SpA (C- 584/13)

VAT: the Kittel principle and 'contra-trading'

Summary - The Court of Appeal confirmed that the Kittel principle applies to 'contra-trading'.

Fonecomp had purchased mobile phones previously purchased and sold by another company as part of a scheme to defraud HMRC. Under the *Kittel* principle (C-439/04), a national court can refuse a trader the right to deduct input tax, in circumstances where the trader knew or should have known that he was taking part in a transaction connected with VAT fraud. The issue was whether the *Kittel* principle is limited to cases where the default occurs in the same chain of supply. If it is not limited in this way, it can apply to a 'contra-trading' transaction.

Decision:

The Court of Appeal observed that in none of the cases decided by the CJEU had the fraud occurred outside the chain of supply. Those cases could therefore not constitute authority for the manner in which the *Kittel* principle should be applied when there had been contra-trading. Furthermore, the cases did not contain a suggestion that the fraud must have taken place in the same chain of supply; and there was nothing to suggest that, by referring to a chain of supply, the CJEU was referring to a purely linear chain. There was, therefore, no reason why the chain of supply should not be connected through a branch.

Finally, the CJEU had not explicitly excluded the possibility of removing the right to repayment in contra-trading situations, despite being aware of its existence, and there was no doubt that this constituted an abuse of the VAT provisions.

The Court of Appeal also rejected Fonecomp's contention that, for the *Kittel* principle to apply, the transaction giving rise to the right to repayment must assist in the achievement of the fraudulent scheme. It added that all that was required was the knowledge that fraud had actually occurred; the knowledge of the specific details of the fraud was not required.

Comments - Since the CJEU's decision in *Kittel*, counsels for taxpayers have attempted to refine the principle so as to exclude certain specific situations. This case is a reminder that 'the propositions in *Kittel* are clear and simple'.

Fonecomp v HMRC [2015] EWCA Civ 39

VAT restitution claim by final consumer

Summary - The Court of Appeal found that the final consumer had a claim for restitution up to the amount of tax actually received by HMRC.

The claimants were all closed-end investment trusts who had obtained investment management services from management companies ('the managers') and had paid VAT on the fees. Under VATA 1994, these services were subject to VAT at the standard rate — although from 1990 there was an exemption for investment management services supplied to authorised unit trust.

In June 2007, the ECJ had ruled that the exemption should apply to closed-end investment funds (*JP Morgan Fleming Claverhouse* C-363/05). This meant that between 1990 and 2008, the UK had failed to transpose the Sixth Directive art 13B(d)(6) into national legislation and that the managers who had supplied the services and accounted for the output tax on them were entitled to make claims for repayment under VATA 1994 s 80.

Decision:

The Court of Appeal pointed out that regard must be had to the economic and commercial reality. The required 'close causal connection' for a mistake-based restitution claim was established, giving rise to a claim by the claimants who had suffered the VAT but not accounted for it.

The claimants had submitted diagrams based on a notional VAT payment to the managers of £100. A second issue was whether HMRC have been enriched to the extent of the full £100 or only to the extent of the £75 actually paid to HMRC after deduction by the managers of input tax.

The Court of Appeal found that the managers should be placed in the position they would have been in had the domestic legislation properly implemented the provisions of the Sixth Directive. No output tax would have been payable and no recovery could have been made in respect of the £25 input tax. The claimants had no better right than the managers to the recovery of the £25.

Comments - The case focuses on the notion of 'unjust enrichment'. It confirms (1) that the final consumer who bears the VAT has a sufficient connection with HMRC to claim that HMRC has been enriched at his expense and (2) that VATA 1994 s 80 limitations cannot apply to him as he never was accountable for the tax and never paid it.

Investment Trust Companies v HMRC [2015] EWCA Civ 82

Let down by adviser

Summary – The Tribunal found that HMRC were entitled to base their decision to register the taxpayer for VAT on the figure in his self-assessment return.

The taxpayer was registered for VAT by HMRC on 1 May 2009 on the basis that the turnover on his self-assessment tax return to 5 April 2009 exceeded the registration threshold. The taxpayer said that his sales figures had been overstated by his accountant, and were below the limit. HMRC also charged a penalty of 15% of the tax due for the late period on the basis that the notification period exceeded 18 months.

Decision:

The First-tier Tribunal said HMRC were entitled to base their decision to register the taxpayer for VAT on the figure in his self-assessment return. It was for the taxpayer to prove that the return was incorrect and he failed to do this. The alternative computation provided was not satisfactory, indicating an under-recording of receipts. The taxpayer's statement that he had paid business expenses out of cash receipts added to the inaccuracy of the daily takings.

The judge decided that the 15% late registration penalty should be mitigated to 5% because the taxpayer had been let down by his accountant.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, said: “This case shows how advisers need to be aware of the VAT registration thresholds when acting for unregistered clients to ensure that the limits are not exceeded on a rolling 12-month basis. A late registration can be corrected by HMRC going back up to 20 years so it is a serious issue. The case also highlights the benefit of keeping all business records to support declared takings figures.”

M Imran v HMRC TC4134

Customs duty classification of tuners

Summary - The FTT found that a device with the function of receiving signals that did not use frequencies was a 'tuner'.

Amino imports internet protocol TV (IPTV) boxes into the UK. The issue was their classification under the EU's Combined Nomenclature (CN) for customs duty purposes. It was accepted that the set top boxes fell with the classification heading 852871, as 'reception apparatus for television … not designed to incorporate a video display or screen'. The issue was whether the IPTV set top boxes were video tuners (subject to 0% duty) or 'other' (subject to 14% duty). IPTVs receive signals in the form of 'data packets' transmitted over the internet. They do not receive a signal on a frequency; however, Amino argued that they were 'tuners' within the modern definition of the term.

Decision:

The FTT accepted evidence that the meaning of 'tuner' had evolved with technology. Originally, TV receiving apparatus had to 'tune' to a frequency, i.e. receive a particular wavelength. This function evolved into isolating a single channel from a frequency that carried more data. Later, when the data was no longer broadcast on a frequency at all, the process of acquiring and isolating a particular channel was still referred to as 'tuning'. The FTT also observed that the definitions of the word 'tuner' overall supported Amino's contention that a device is a 'tuner' if it receives a broadcast of a number of TV signals from which it isolates one channel, even if the broadcast is not transmitted on a frequency.

Comments - With the constant advent of new technologies, the meaning of technical terms can evolve over time. The case is a useful example of the way the FTT will approach those issues; focusing on functionality and meaning in the English language.

Amino Communications v HMRC [2015] UKFTT 0035

VAT: sale of a building and TOGC

Summary - The UT found that the sale of a building was not a transfer of a going concern.

The Royal College — a charity whose activities are primarily non-business or exempt — owned premises which it partially let to BAPM, another charity. It had purchased a building and the issue was whether the sale qualified as a transfer of a going concern (TOGC).

The Royal College had been advised that the sale would qualify as a TOGC if the vendor, Coleridge, entered into an agreement for the lease of part of the building with BAPM prior to its sale. The sale was then completed, subject to the agreement and on the basis that it was a TOGC.

Decision:

Distinguishing *Dartford Borough Council* [2007] Decision No. 20423, the UT stressed that BAPM had already been a tenant of the Royal College, which had introduced it to Coleridge. Furthermore, the agreement for the lease was conditional on the sale of the freehold and therefore formed part of the same arrangement.

The critical feature was the relationship between BAPM and the Royal College, which was not altered by the sale. The lease that was transferred was not part of the business of Coleridge.

The UT found, however, that HMRC had been time barred from raising an assessment on the basis that the return had been incorrect and so the appeal was dismissed.

Comments - HMRC guidance (*Notice 700/9/02*) provides that when property is transferred with the benefit of a prospective tenant, the transfer should qualify as a TOGC. This case suggests that this will not be the case where the relationship between the prospective tenant and the purchaser exists before the transaction.

HMRC v Royal College of Paediatrics and Child Health [2015] UKUT 0038