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Personal Tax

Benefits in kind: zero-emission vans and loans (Lecture P891 – 8.04 minutes)

Zero-emission vans

For the last five tax years, S155 ITEPA 2003 has ensured that a company van is not subject to a benefit in kind charge for private use provided that it cannot in any circumstances emit CO_2 by being driven. This means that the van will be powered entirely by electricity or by a hydrogen fuel cell.

This nil rate charge came to an end with effect from 6 April 2015. For 2015/16, a figure of 20% of the normal van benefit for that tax year (ie. 20% x £3,150 = £630) will be chargeable on drivers of zero-emission vans (S10 FA 2015).

Thereafter, the rate will rise on a tapered basis as follows:

Tax year	Relevant percentage
2016/17	40%
2017/18	60%
2018/19	80%
2019/20	90%
2020/21	100%

The percentage is applied to the van benefit for that tax year so that the benefit for zero-emission vans in 2020/21 is precisely the same as for vans which emit CO_2.

However, if the driver of a zero-emission van (or, indeed, any other van) meets the restricted private use condition set out in S155(4) ITEPA 2003, the cash equivalent of his benefit will remain at nil.

Loans

Where an employer provides an employee with a loan which is either interest-free or subject to a low rate of interest, there is no taxable benefit if the aggregate of all such loans does not exceed £10,000 in the tax year – see S180 ITEPA 2003. Nor is there a Class 1A NIC charge.

When considering whether the limit of £10,000 has been exceeded, any employer-provided loans which would attract income tax relief (ie. because they were made for a qualifying purpose) are ignored.

The official rate of interest for beneficial loans has been reduced to 3% for 2015/16 (SI 2015/411).

Contributed by Robert Jamieson

Rental property and the renewals basis **(Lecture P892 – 13.15 minutes)**

Prior to 6 April 2013, the landlord of a furnished residential property had a choice when he came to replace items in the house or flat. He could claim the renewals basis. Alternatively, he could claim a wear and tear allowance, calculated as 10% of the net rent, ie. rent less expenses such as utilities, council tax and anything else for which the tenant is usually responsible. In practice, the 10% wear and tear allowance, which is a statutory claim under Ss308A – 308C ITTOIA 2005, was normally preferred.

If the property was not fully furnished (for example, if it only contained kitchen appliances), the 10% wear and tear allowance is not available – see S308B ITTOIA 2005. The renewals basis would have been the only option in these circumstances.

This renewals allowance worked on the basis that one cannot have a tax deduction for the first purchase of a piece of equipment. Instead, when that item needed to be replaced, the cost of the replacement could be claimed as a renewal. Thus, if an individual was fitting out a new rental property, there was no relief for the expense of buying a cooker or fridge-freezer. However, when, say, the fridge-freezer was replaced, the cost of the new one represented an allowable deduction.

Following the publication of a technical note on 6 December 2011, HMRC announced that the renewals basis would not be available for replacement expenditure on plant or equipment which was incurred on or after 6 April 2013. With effect from that date, the sole relief available to residential landlords is the 10% wear and tear allowance and, because this can only be claimed in connection with fully furnished properties, it follows that landlords of unfurnished (or partly furnished) residential accommodation cannot claim relief for the cost of replacing items such as cookers, fridges, dishwashers and so on.

There is, however, an argument which maintains that equipment such as cookers and other white goods qualify as 'trade tools' under S68 ITTOIA 2005 so that their costs are deductible by virtue of statute. If so, the loss of the renewals basis would be less of a problem.

S68 ITTOIA 2005, which deals with replacement expenditure, reads as follows:

'(1) This section applies if:

(a) expenses are incurred on replacing or altering any tool used for the purposes of a trade; and

(b) a deduction for the expenses would not otherwise be allowable in calculating the profits of the trade because (and only because) they are items of a capital nature.

(2) In calculating the profits of the trade, a deduction is allowed for the expenses.

(3) In this section "tool" means any implement, utensil or article.'

Given that *Caledonian Railway Co v Banks (1880)* established that rolling stock could be treated as what are now called 'trade tools', it seems not unreasonable to extend that argument to cookers and fridges in a partly furnished rental property.

Having said that, the position was by no means clear and so a letter sent to HMRC on 4 February 2014 under the joint auspices of the CIOT and the Tax Faculty requested clarification of the position.

HMRC replied on 7 April 2014 and there are elements of their response which are encouraging. For example, they confirm that the more expensive built-in appliances are regarded as fixtures and so are deductible as repairs – in other words, they are dealt with under the normal rules for fixtures, ie. replacing a fixture without improving it beyond its original condition is allowable. However, HMRC did say that S68 ITTOIA 2005 does *not* give an alternative deduction for free-standing appliances such as fridge-freezers and for carpets or curtains. It would appear that smaller items which are regularly replaced, eg. toasters, crockery, cutlery and glassware, do fall within the definition of 'trade tools' in S68 ITTOIA 2005 and therefore are deductible under this provision. This is of course subject to the caveat that the landlord must not be claiming the 10% wear and tear allowance.

The following extract from the HMRC letter may be helpful:

'S68 ITTOIA 2005 relates only to items of a capital nature that are of a relatively low value and have a short useful economic life that would need to be regularly . . . replaced in the ordinary course of business due to normal wear and tear. This would be on items such as crockery and rugs for instance, ie. low-cost soft furnishings that might be expected to be replaced fairly regularly. However, it would not apply to carpets, for instance, as they are a capital item of potentially higher value that you would not expect to replace regularly. However, landlords may be able to get some relief on carpets if the expenditure qualifies as a revenue expense.

White goods such as washing machines and fridges are not covered by the statutory renewals allowance as they are capital items not part of the entirety (the property). However, where white goods are fitted (ie. integrated hobs and ovens), we recognise these as part of the entirety (the property) and so these would be deductible as a repair when replaced.

To confirm, therefore, anything free-standing such as a fridge-freezer will not become part of the entirety (the property) for residential lettings and therefore would not be deductible under S68 ITTOIA 2005.'

The reference to a 'statutory renewals allowance' is to S68 ITTOIA 2005 and the official HMRC guidance on this section can be found in Para BIM46960 of the Business Income Manual. The case law dealing with the concept of an 'entirety' can be found at *O'Grady v Bullcroft Main Collieries Ltd (1932)* and *Samuel Jones & Co (Devondale) Ltd v CIR (1951)*.

<u>A recent development</u>

Following the submission of the latest set of tax returns, the impact of the withdrawal of the renewals basis for 2013/14 onwards is only now being realised by landlords.

In conjunction with the CIOT, the Tax Faculty asked the Residential Landlords Association to survey their members earlier this year in order to discover:

(i) whether landlords were aware of this change in the tax rules;

(ii) if the change would impact on the frequency with which they will be replacing white goods, carpets and curtains; and

(iii) whether or not they would be reorganising their businesses so that they move away from having partly furnished lets to being fully furnished or totally unfurnished.

The results were very interesting. Of the 628 responses from landlords, over 75% were unaware of HMRC's removal of the renewals basis. A clear majority of landlords said that they currently provide:

(i) white goods (74%);

(ii) carpets (98%); and

(iii) curtains (79%)

in their non-fully furnished rental properties and more than half confirmed that the lack of tax relief would have an effect on the frequency with which such items were replaced in the future.

Those landlords who change to having fully furnished lets will then be eligible for the 10% wear and tear allowance. This is likely to cost the Treasury more than allowing renewal costs for non-fully furnished lets. It is understood that the Tax Faculty will be taking this point forward.

<u>Companies</u>

These notes have been written from the perspective of an individual landlord, ie. one who is subject to income tax. For completeness, it should be made clear that the equivalent statutory provisions for corporate landlords are:

(i) 10% wear and tear allowance (Ss248A – 248C CTA 2009); and

(ii) statutory renewals allowance (S68 CTA 2009).

And, for companies, the renewals basis was abolished for expenditure incurred on or after 1 April 2013.

Contributed by Robert Jamieson

Rectification is solution

Summary - The UT allowed the taxpayer's appeal on the ground of rectification

The taxpayer, a Dutch national, moved to England in 2004. He sold his home in the Netherlands and invested the proceeds in life insurance policies with Zurich Life. In 2007 and 2008, he made withdrawals from the policies to fund the purchase of a house in the UK. To make the withdrawals, the taxpayer had to complete a form that contained four surrender options. He opted for partial surrender across all policies.

Because he had withdrawn no more than he had paid in to the policies the taxpayer believed no taxable gain would arise and did not include the withdrawals in his tax returns for 2006/07 and 2007/08. Zurich, as it was legally required to do, disclosed the withdrawals to HMRC. As a result, the department enquired into the returns and concluded that tax was due on the income from the withdrawals under ITTOIA 2005, s 461.

On discovering the effect of the taxpayer's action, Zurich offered to recalculate the chargeable event certificates, "based on what would be the more appropriate method of making withdrawals from the investment". HMRC rejected the offer, saying that the tax charge was correct. The First-tier Tribunal dismissed the taxpayer's appeal.

Decision:

The Upper Tribunal referred to the decision in *Pitt v Holt* [2013] STC 1148 in which the Supreme Court ruled that a mistake about the tax consequences of a transaction could be sufficiently serious to warrant rectification. In this case, the mistake had been the taxpayer's but there was "no doubt" that, had he understood the "devastating tax consequences of his choice of withdrawal method", he would not have proceeded.

HMRC "pressed" on the judge that the taxpayer "could and should have taken advice" about the method of withdrawal. The fact was, according to HMRC, that the taxpayer now wished he had not done what he did. The judge did not agree. He said it was not necessary to seek advice on every matter and "no reasonable man would have expected the outcome".

He concluded that the taxpayer was entitled to rectification.

Noting that several similar cases were stayed awaiting the outcome of *Lobler* and that rectification may not be open to all those affected, the judge considered the taxpayer's human rights under art 1 of the first protocol to the European Convention on Human Rights. He concluded his rights had not been breached. The tax had been calculated in accordance with the legislation and the aim of that statute was legitimate. The legislation could appear unfair but it was not discriminatory.

Finally, HMRC could have used their discretion to amend the taxpayer's return, but whether they had acted unlawfully in refusing to do so was a question for judicial review, not an appeal.

The taxpayer's appeal was allowed.

Comments - The CIOT was allowed to make written submissions and to address the tribunal, on the basis that many taxpayers faced issues similar to those in that case. The CIOT intends to make formal submissions to HMRC and the Treasury to obtain a change in the law

Andrew Hubbard said: “Almost everybody would agree that the tribunal reached a conclusion that was equitable. As the judge said, nobody would wittingly contract to pay an amount of tax that would effectively lead to his own bankruptcy if there were a choice not to do so and achieve the same goal. The solution reached relied on general legal principles rather than the operation of tax law.”

He added: “There is, in my view, still a need for a tax law solution to the problems created by the strict interpretation of the statute that led to an outcome which is manifestly unfair.”

Joost Lobler v HMRC [2015] UKUT 152

Members of an LLP and loss relief

Summary - The UT dismissed a claim for loss relief by a member of a limited liability partnership (LLP).

The Renaissance Club at Archerfield (RCA), an LLP which ran a golf course, had made substantial trading losses. It had sought to surrender its losses to one of its members, HKAL. The issue was the calculation of the limit for relief claimed by members of an LLP under ICTA 1988 s 118ZC. Under this provision, the amount of loss relief which can be claimed by a member of an LLP is 'the greater of the amount subscribed by it and the amount of its liability on a winding up'.

HMRC contended that this was a straightforward case. HKAL had made no contribution and, under the LLP agreement, had no liability to contribute on a winding up. HKAL was therefore not entitled to any of the LLP's losses. HKAL argued that a one-third share of the $8m contributed by the other member of the LLP was credited to HKAL's capital account and that amount was at risk in the event of a winding up.

Decision:

The UT noted that the differences between limited partnerships and LLPs did not warrant different approaches to the concept of 'contribution', although some adjustments were necessary. The UT also rejected the contention that the same payment by a single member could give rise to a subscription by two members. Moreover, HKAL, having provided nothing in capital contribution terms, took no risk at all of losing capital.

Finally, the UT noted that the policy of s 118 et seq. was to allow claims up to the amount which the members stood to lose if the LLP was wound up because it was insolvent. 'It was hardly likely' that parliament had intended a member which had contributed nothing (and which was not liable to contribute on a winding up) to be able to benefit from loss relief.

Comments - The UT robustly rejected arguments that s 118ZC led to absurd results because members of an LLP do not have to contribute to its capital. It preferred to adopt an interpretation which implemented parliament's overall intention.

HMRC v Hamilton & Kinneil (Archerfield) and others [2015] UKUT

Stripped interest coupons

Summary - The UT found that a scheme involving discounts on stripped interest coupons did not work.

The joint cases involved a scheme, sold by a bank, which was designed to provide a higher return on cash than could have been obtained by placing it on a conventional short-term deposit. The bank stripped interest coupons for the requisite period from a high grade fixed or floating rate bond. The bank then sold the relevant bond to the taxpayer at a discounted price. Finally, the taxpayer held the bond until the end of the stripped period and sold it on the market for its full undiscounted value. The scheme relied on the facts that no profit of an income nature was receivable on the bonds (as no interest was payable) and that the gain realised on the sale of the bond was exempt from CGT as the disposal of a QCB.

Decision:

Agreeing with the FTT, the UT found that Mr Savva's profit was a discount of an income nature under ITTOIA 2005 s 381. The only function of the discount was to compensate him for the interest coupons which had been stripped from the notes before they were sold to him. However, that Mr Savva had not received a separate security. The underlying securities remained unchanged, although the beneficial ownership of the rights attached to them had been split between the bank (which was entitled to interest) and Mr Savva (who held the right to capital on maturity). Mr Savva was therefore not chargeable to income tax under ITTOIA 2005 Chapter 8 (deeply discounted securities).

Comments - In deciding whether the taxpayer's return was of an income nature, the UT focused on the purpose of the discount, which was to compensate for the loss of interest. The fact that the entire transaction had been entered into to obtain a higher return on deposits was not directly relevant.

Philip Savva and others v HMRC [2015] UKUT 141

Discount on stripped coupon security

Summary - The UT found that a discount on a stripped coupon security was of an income nature.

Mr Healey had purchased commercial securities issued by a bank and from which the interest coupons had been stripped. The price paid by Mr Healey was lower, to reflect the low return on the coupons. The interest coupons were later reattached to the notes, which Mr Healey then sold on the market for their full market price. This provided him with an after-tax return much higher than on a fixed-term deposit.

It was accepted that Mr Healey had acquired the notes at a discount 'in the normal commercial sense of the term'. The issue was whether the discount was of an income nature (chargeable under ICTA 1988 Sch D Case III).

Decision:

The UT found that the discount was clearly not intended to compensate Mr Healey for any capital risk, as the issuer had a high credit rating. Clearly, the purpose of the discount was to compensate Mr Healey for the absence of interest. The position was essentially the same as it would have been if Mr Healey had bought a non-interest bearing note issued at a discount. From Mr Healey's perspective, it was immaterial that interest was payable to a third party.

The UT stressed, however, that the fact that the transaction was marketed as a way of providing an enhanced after-tax return was not relevant when ascertaining the tax position.

Comments - The UT focused on the acquisition of the notes at a discount, rather than on their disposal at a profit. The discount was of an income nature as it compensated for the absence of interest. The scheme would not have achieved its intended result today, as income tax returns which are economically equivalent to interest are charged under FA 2013 s 12.

Malcolm Healey v HMRC [2015] UKUT 140

EIS and reverse takeovers

Summary - The FTT confirmed that a company which had undergone a 'reverse takeover' ceased to qualify for EIS.

PhotonStar LED had 12 to 15 enterprise investment scheme (EIS) investors. It sought an AIM listing and started negotiations with Enfis for a 'reverse takeover'. Both companies were in the LED lighting business and Enfis' shares also qualified for EIS. Enfis acquired PhotonStar by way of a share for share exchange, HMRC having confirmed that Enfis would continue to be 'a qualifying company' for the purpose of EIS.

Following the reverse takeover, HMRC wrote to PhotonStar informing it that it no longer qualified for EIS, stating that EIS is withdrawn where the company becomes the 51% subsidiary of another company (ITA 2007 s 185), or where shares in the company are sold within three years of their issue (ITA 2007 s 209).

The appellants' main argument was that PhotonStar and Enfis had become one company, so that PhotonStar had not become a subsidiary.

Decision:

The FTT found that whilst 'superficially attractive', treating two distinct body corporates as one would introduce uncertainty for many purposes. Although the two companies were carrying out the same business with the same management, it could not be said that they formed a single company; and so PhotonStar had become a 51% subsidiary.

Comments - The FTT observed that it was 'unfortunate' that relief should be withdrawn in circumstances where a company which qualifies for EIS is taken over by another company which also qualifies.

Gregory Finn and others v HMRC [2015] UKFTT 144

Capital Taxes

Capital gains on property disposals

Summary - The FTT upheld discovery assessments relating to the disposal of three properties.

The taxpayers had sold three properties that they had previously held jointly. Neither of them had disclosed the disposals in their tax return. The issue was the calculation of the capital gains.

Decision:

The FTT first rejected the taxpayers' contention that disposal monies paid by their solicitor to redeem mortgages were not part of the consideration. The relevant question was 'what did the purchaser give up'. Secondly, the acquisition cost was not net of the mortgage amount. Again, the mortgage amount was part of what the appellants had given up to purchase the property and was therefore part of the acquisition cost. Finally, TCGA 1992 s 38 allowed the deduction of costs 'incidental' to the acquisition and disposal. The list of such incidental costs contained in s 38 was exhaustive and did not include mortgage fees. The FTT accepted, however, that under the vendor paid deposit scheme which had been used for one of the properties, the deposit had moved not from the purchaser but from the vendor, so that it had not been part of the consideration.

Finally, the FTT found that Mr Day had not occupied the third property so as to qualify for private residence relief. The FTT accepted that the appellants may have had a row; however, the split had not been permanent enough for Mr Day to purchase a property with the intention of occupying it as his main residence. The FTT found however that the costs incurred in painting the property were deductible as they would have enhanced its value.

Comments - The case confirms that a mortgage amount is part of the consideration and that mortgage fees are not deductible when calculating a capital gain. Taxpayers should be mindful of 'dressing up' the occupation of a property as that of a principal residence. Without evidence of a degree of permanence and continuity of occupation, private residence relief will not be available.

John Arthur Day and Amanda Jane Dalgety v HMRC [2015] UKFTT 139

Scrip dividends and the exit charge

Summary - The FTT confirmed notices of determination in relation to a settlement.

The appellants were the trustees of a settlement. They had received a scrip dividend and, a few days before the tenth anniversary of the commencement of the settlement, they had made a distribution worth over £1m to certain beneficiaries. The issue was the rate of the exit charge for IHT purposes.

The trustees contended that the scrip dividend was income and had not been accumulated as capital. As such, it did not fall to be taken into account in calculating the exit charge and so no tax was due on the distribution. HMRC argued that the scrip dividend was capital and that trust property had ceased to be 'relevant property', and so an exit charge was due at the rate of 4.81%. This rate was high due to the proximity to the tenth year anniversary.

Decision:

The FTT noted that there were conflicting decisions on the tax status of scrip dividends. It added that it was bound by the most recent first instance decision, that of the UT in *Gilchrist* [2014] UKUT 169. Consequently, the scrip dividend was capital in the hands of the trustees.

The FTT then set out to assess the exit charge (IHTA 1984 s 68). The issue was the extent to which property should be treated as becoming comprised in a settlement after the date of commencement. The UT noted that a scrip dividend involves new shares becoming comprised in the settlement; and that property can become comprised in a settlement without being the object of a disposition. The scrip dividend was therefore comprised in the settlement for the purpose of s 68 and the exit charge was due. Finally, even if the scrip dividend had been income, the trustees had not established that it had not accumulated as capital.

Comments - Despite conflicting authorities, the case establishes (for now) that a scrip dividend is capital in the hands of trustees of a settlement and can be comprised in that settlement for the purpose of the IHT exit charge.

Meena Seddon and others v HMRC [2015] UKFTT 140

Failure of a capital loss scheme

Summary - The UT found that a capital loss scheme failed under the Ramsay principle.

The taxpayers had participated in schemes designed to create capital losses. Their success was predicated on the participants having spent large sums on acquiring assets and having realised very small amounts on their disposal. This, in turn, depended on the disapplication of TCGA 1992 s 17, which deems a transaction between parties who are not dealing at arm's length to be at market value. The FTT had found that the transactions had been at arm's length, so that s 17 was not in point; however, the FTT had drastically reduced the acquisition price (TCGA 1992 s 38) and therefore the loss. This was the main issue of this appeal.

The FTT had found, by way of example, that one participant in the scheme had paid £1 for an option and £6m when exercising the option. Under the scheme, however, he was the beneficiary of a trust endowed with assets which were available to him and worth £6m. The FTT had therefore concluded that the £6m had not been paid for some 'worthless shares', but for the scheme as a whole, the value flowing into the trust.

Decision:

Referring to *Arrowtown* [2003] HKCFA 46, the UT stressed the requirements to 'construe statutory provisions purposively' and to 'view transactions realistically'.

The UT confirmed that the FTT had asked the right question; what did the taxpayer pay for? The obvious answer was that he had not outlaid £6m for some 'worthless shares'. Similarly, the FTT had adopted the appropriate realistic approach when concluding that the subscription for the shares had not been an isolated transaction, but had formed part of a composite and preplanned series of steps. The UT therefore found that the factual conclusion was open to the FTT, given that 'a person does not normally pay £6m for an asset worth £600'.

Comments - This case is a practical example of the application of the *Ramsay* doctrine to a set of circular and preordained steps entered into for the purpose of tax avoidance. Interestingly, rather than simply recharacterising the transactions by ignoring artificially inserted steps, both tax tribunals simply found that the monies expended did not represent the acquisition cost of the shares — which was, therefore, much lower.

Steven Price and others v HMRC [2015] UKUT 164

Contingent liabilities and CGT **(Lecture P893 – 19.54 minutes)**

The recent judgment of the Scottish Court of Session in Morrison v HMRC (2014) has upheld the taxpayer's appeal from the Upper Tribunal's decision which went in favour of the taxing authorities in October 2013.

The taxpayer, Sir Fraser Morrison, was a major shareholder in, and chairman and chief executive of, Morrison plc which was taken over in September 2000 by Anglian Water plc (A) for around £263,000,000. Sir Fraser's share of the consideration (in the form of shares and loan notes) came to £33,400,000. These securities were subsequently transferred to a trust which gave rise to a substantial chargeable gain.

During the course of the takeover negotiations, Sir Fraser (in his capacity as chairman) authorised the sending of the company's five-year strategic plan to A – this plan included a profit forecast for the year ended 31 March 2001. Subsequently, additional information was provided by Sir Fraser as to the state of Morrison plc's business, in which an assurance was given that there were no other matters of which A should be aware.

Unfortunately, the profit forecast turned out to be materially inaccurate and so, in August 2002, A brought an action in the High Court against Sir Fraser and one of his fellow directors, in which they alleged that they had been induced by the defendants' false misrepresentations to offer far more than Morrison plc was worth. The sum sued for was £132,000,000.

Three and a half years later and shortly before the case came to trial, the matter was settled out of court by a payment from Sir Fraser of £12,000,000 ('without acceptance of liability'). As a result, Sir Fraser's accountants then claimed a deduction of this amount by way of adjustment to his gain on the transfer to the trust. They argued that the settlement of the High Court action constituted the enforcement of a contingent liability in respect of a representation made on the disposal of Sir Fraser's shares, the relevant provision being S49 TCGA 1992 which states that, where a contingent liability subsequently arises and is enforced, an adjustment can be made to reduce the gain. This claim was refused by HMRC on the ground that the payment of £12,000,000 was not part of the consideration for the paper-for-paper exchange in September 2000 – it was not directly referable to the value of the consideration received by Sir Fraser and so could not be brought within S49 TCGA 1992.

The case initially went to the First-Tier Tribunal where the taxpayer was successful. It was held that Sir Fraser fell within the ambit of S49(1)(c) TCGA 1992. He was therefore entitled to the benefit of an adjustment under S49(2) TCGA 1992. HMRC then appealed to the Upper Tribunal who found in their favour (see (a) above). The latest step was the hearing before the Scottish Court of Session.

It is worth at this stage reproducing the relevant parts of the statutory framework. S49 TCGA 1992 provides:

'(1) In the first instance no allowance shall be made in the computation of the gain . . .

(c) for any contingent liability in respect of a warranty or representation made on a disposal by way of sale or lease of any property other than land.

If any such contingent liability subsequently becomes enforceable and is being or has been enforced, there shall be made, on a claim being made to that effect, such adjustment, whether by way of discharge or repayment of tax or otherwise, as is required in consequence.'

The Scottish Court of Session expressed the view that, for this purpose, a contingent liability is a liability which depends for its existence upon an event which may or may not happen – this includes liabilities which emerge after the date of the disposal and which arise as a consequence of a state of affairs already in existence at that time. Lord Tyre, in his judgment, continued:

'It follows that, when construing the expression "contingent liability" in S49(1)(c) TCGA 1992, it is unnecessary to identify an event which, at the time of a disposal by way of sale, may or may not happen.'

The Upper Tribunal had argued that a contingent liability must be incurred by the taxpayer in his capacity as a seller and that it had to be directly related to the value of the consideration received by him on the disposal. Lord Tyre was not in complete agreement with this analysis, but he concluded – unlike the Upper Tribunal judge – that Sir Fraser had anyway satisfied the test.

He stated:

'In my view, the capacity in which the representations were made should not be regarded as making a critical difference.'

And he went on to point out that 'there is no reference in S49(1)(c) TCGA 1992 to the capacity of the person making the disposal'.

He then summed up the Court's position with these words:

'The basis upon which (Sir Fraser's) personal contingent liability arose was that he made the representations which induced the purchase of the shares, including those owned by himself. In these circumstances, I consider that the representations are properly described as having been made on a disposal by way of sale of the shares. The requirements of S49(2) TCGA 1992 for adjustment of the computation of (his) chargeable gain are therefore met. I am further satisfied that this conclusion reflects the reality that, after making the payment in settlement of A's claim, the gain realised by (Sir Fraser) on the disposal of his shares was reduced by £12,000,000.'

There was, however, one final difficulty. Lord Tyre and his fellow judges found it necessary to remit the case to the First-Tier Tribunal so that a decision could be reached as to how much of the payment of £12,000,000 was strictly referable to the representations made and whether any part of that payment related to other matters (in which case it would not be fully deductible).

Contributed by Robert Jamieson

Good news for the villa in the south of France! (Lecture P894 – 8.57 minutes)

For clients owning property in continental Europe, there has always been the problem of what happens to the property on the owner's death, which can be further compounded by tax issues. Most European countries such as France, Spain and Italy operate 'forced heirship' rules so that the owners of real estate situated in the overseas jurisdiction must leave a share of the property directly to their children on death – they cannot bequeath the entire property to their other half. This usually means that the surviving spouse cannot then deal with or sell the property without first having obtained the children's agreement and, of course, a requirement such as this may also give rise to additional IHT charges for the estates of deceased UK domiciliaries.

With effect from 17 August 2015, the good news is that this situation is changing for the better. New EU legislation taking effect for deaths occurring on or after 17 August 2015 will mean that UK citizens can make a choice in their will to apply their own national law to foreign property in an EU member state. This will enable the deceased to leave the whole property to a surviving spouse so that it will only pass to the children on the second death.

It is also likely to improve the tax position and avoids the need for some of the complex, and less advantageous, arrangements which have had to be put in place in the past (eg. usufructs).

The choice of the applicable legal regime can be included in wills signed from now onwards, although, as mentioned above, it will only be effective for deaths on or after 17 August 2015. Some complexities will undoubtedly remain and professional advice should still be taken, but the expectation is that the new regulation, which is known as 'Brussels IV', will solve what has hitherto been a major potential headache for many individuals who own European property such as a holiday home.

Contributed by Robert Jamieson

New IHT exemptions (Lecture P895 – 16.13 minutes)

<u>The ending of the *Frankland* trap</u>

It has been common practice to avoid making an appointment of capital out of a discretionary will trust within three months of the settlor's death if reading back under S144 IHTA 1984 is being sought. In *Frankland v CIR (1997)*, the trustees of such a trust appointed an interest in possession to the deceased's husband within three months of her death. They had hoped to obtain relief under S144(1)(a) and S18 IHTA 1984, but, because of S65(4) IHTA 1984, there was no exit charge and therefore no event which could bring S144 IHTA 1984 into play. This is because reading back under S144 IHTA 1984 is only available where there is 'an event on which tax would . . . be chargeable' and there is no such event if the will trust comes to an end within three months of its creation. Of course, following FA 2006, it was no longer necessary to wait three months before appointing an interest in possession, but the trap remained after the enactment of that legislation for *outright* capital appointments.

However, for deaths occurring on or after 10 December 2014, S144 IHTA 1984 has been amended so that, where a will trust is wound up within three months of the death and an appointment of property is made in favour of the deceased's spouse (or civil partner), that appointment can now be read back into the will. As a result, the spouse exemption under S18 IHTA 1984 is available. This amendment removes what many people regarded as an unnecessary anomaly in the IHT code.

<u>Decorations and other awards</u>

S6 IHTA 1984 states that a decoration or other award represents excluded property for IHT purposes if:

(i) it was awarded for valour or gallant conduct; and

(ii) it has never been the subject of a disposition for a consideration in money or money's worth.

In the 2014 Autumn Statement, the Chancellor announced that this IHT exemption covering awards for valour and gallantry was to be extended with immediate effect (ie. for transfers made on or after 3 December 2014) to include awards for service in the armed forces and awards made by the State in recognition of achievements and service in public life (eg. OBEs). The new exemption will also include similar orders, decorations and awards made by other countries and territories.

Emergency service personnel and others

The Government announced last year that they intended to introduce an IHT exemption for members of emergency services in line with the existing rule in S154 IHTA 1984 for members of the armed forces who die in the line of duty or whose death was hastened by an injury sustained in that line of duty. Subsequently, it was reported that the exemption would be extended to cover police constables and armed service personnel who die as a result of being attacked due to their professional status.

The main result of these changes, which take effect for deaths occurring on or after 19 March 2014, is that, where:

(i) a member of the emergency services or a humanitarian aid worker dies as a result of responding to an emergency (see new S153A IHTA 1984); or

(ii) a police constable or a member of the armed services dies as a result of their status (see new S155A IHTA 1984),

their estate will be exempt from IHT. In addition, any further IHT due on death for chargeable lifetime transfers and potentially exempt transfers will not be payable. This last point has also been included in S154 IHTA 1984 for soldiers, sailors and airmen.

Contributed by Robert Jamieson

Administration

Not exceptional

Summary – The Tribunal confirmed the sizeable penalties despite the lack of a tax liability for the relevant year.

The taxpayer was late filing his 2010/11 tax return, submitting it on 13 August 2012 instead of 31 January. As a result, HMRC imposed an initial late filing penalty of £100, 90 daily penalties totalling £900 and a six-month late filing penalty of £300.

The taxpayer claimed he had a reasonable excuse for the lateness. During 2009 to 2011, he had been unemployed for several months, his mother had been diagnosed with breast cancer and his wife had been unwell.

HMRC said these constituted neither reasonable excuse nor special circumstances. He was employed during the period of delay — January to August 2012 — and, while he would have been concerned about his wife and mother, this was not an exceptional factor.

Decision:

The First-tier Tribunal noted the penalty was "significant" at £1,300 and that no tax was due from the taxpayer for 2010/11. However the duty to file a return remained and the taxpayer should have been aware of this. The judge accepted that the taxpayer "in the immediately preceding period" was worried about his wife and mother, but this was not relevant for the period January to August 2012 covered by the penalties.

The tribunal was sympathetic to the taxpayer, but had no option except to confirm the penalties.

The taxpayer's appeal was dismissed.

Comments – This case demonstrates how important it is for taxpayers to deal with their affairs in a timely manner and how penalties can rack up. It appears particularly unfair bearing in mind the lack of a tax liability in that tax year but as stated the tribunal was sympathetic to the taxpayer, but had no option except to confirm the penalties.

D Tate v HMRC TC4327

Appeal by a partner who is not the representative member

Summary - The FTT struck out an appeal on behalf of a partnership by a partner who was not the representative partner.

Mr Dyson and Mr Walker had formed a partnership, of which Mr Walker was the representative partner. Penalties were issued against the partnership for late filing; and Mr Dyson sought to appeal against these. The issue was whether Mr Dyson had a right of appeal, given that he was not the representative partner.

Decision:

The FTT noted that the TMA 1970 does not define 'representative partner' but that, in practice, a partnership is required to register with HMRC using form SA400, which asks the partnership to identify the representative partner. The FTT observed that, although HMRC can levy late filing penalties on all 'relevant' partners, under TMA 1970 Sch 55 para 25(4), only the representative partner or his successor has a right of appeal. This means that an appeal by the representative member would encompass the penalties charged on both partners.

The FTT also referred to an interim report by the Office of Tax Simplification, published in January 2014, which highlighted the potential for 'significant unfairness' in those provisions. A partner who is not the representative partner, but who believes that he has a reasonable excuse, cannot appeal.

Finally, the FTT pointed to the European Convention on Human Rights art 6, which entitles anyone faced with a criminal charge to a 'fair and public hearing', it being accepted that tax penalties are 'criminal' for these purposes. The FTT added that under the Human Rights Act 1998 s 3, UK legislation must be 'read and given effect in a way which is compatible with the Convention rights'. It was, however, not possible to read Sch 55, para 25(4) in a way that made it compatible with ECHR.

Comments - Clearly, the appellant's right under ECHR had been breached, yet the FTT was unable to enforce those rights and the appeal was struck out. It therefore seems that, in cases of absolute conflict between the ECHR and domestic legislation, domestic legislation will prevail.

Jack Dyson v HMRC TC4336

What are the statutory records?

Summary - The FTT found that most documents requested by HMRC were not statutory records; the taxpayer was, however, required to produce them.

HMRC had opened enquiries into Mr Mathew's returns for the years 2008/09 through to 2012/13. He was appealing against information notices (issued under FA 2008 Sch 36) and applying for a direction that HMRC close all enquiries.

The first notice required (inter alia) the provision of a schedule of shareholdings.

Decision:

Under FA 2008 Sch 36 para 29(2), a taxpayer cannot appeal against an information notice requiring the production of statutory records. As there had been no acquisitions or disposals of shareholdings during the relevant period, the schedule was not relevant to the preparation of the tax return and so Mr Mathew had a right of appeal against this item of the information notice.

Similarly, the FTT found that loans for purchasing personal assets and employment contracts were not 'requisite' for the purpose of completing a tax return and were therefore not statutory records. Both items were, however, reasonably required by HMRC to bridge the gap between Mr Mathew's standard of living and his income.

Furthermore, the fact that HMRC could obtain the information from other sources was immaterial.

Finally, in relation to the closure notice application, the FTT found that given the volume of information and documents which remained to be produced, it would be premature to issue a closure notice.

Comments - The FTT examined in detail each information notice, setting out the reasons why the taxpayer was entitled to appeal and why HMRC was entitled (bar some modifications) to seek the information. This case is a useful practical example of the way the FTT will view such issues.

Joshy Mathew v HMRC 2015 UKFTT 139

Information notices and statutory records

Summary - The FTT partially allowed an appeal against an information notice.

HMRC was applying to strike out an appeal against an information notice issued under FA 2008 Sch 36. Couldwell had appealed on the grounds that the documents required were not statutory records and that the information notice wrongly required it to prepare or create documents in a format in which they did not exist.

Decision:

The FTT linked the definition of 'statutory records' in Sch 36 to the obligation to keep records imposed by FA 1998 s 21(5). It pointed out that this provision requires a company to keep all records which are 'necessary to establish, without doubt, that a return is accurate'. The FTT also noted that the fact that a request for information required some act of accountancy did not mean that the information requested was not a statutory record. If there was a duty to keep the information, then it was a statutory record. However, the way the information was provided was up to the taxpayer.

The FTT also noted that in the case of a request for documents (as opposed to information), the taxpayer was only under the obligation to provide documents that it had in its possession or power. The appeal was therefore struck out.

Couldwell was also appealing against information notices requesting both information and documents relating to car benefits. The documents (bank statements) were statutory records and therefore no appeal lay against the information notice. However, the FTT found that the information requirement was vague and ambiguous. For instance, the request for miles travelled did not specify whether it related to business or private mileage or which individuals were relevant. The appeal was therefore allowed in relation to the information requirement.

Comments - The FTT made some interesting remarks in relation to its jurisdiction. It noted that it could not hear an appeal against a notice requiring statutory records (however vague and ambiguous), but that it could hear an appeal against a penalty for non-compliance with that notice. Additionally, the FTT could vary a request for information. However, in cases such as this one, where the request was so vague that the FTT could not 'reasonably vary it so as to identify information which would be reasonably required', it must be set aside.

Couldwell Concrete Flooring v HMRC TC4340

Tax fraud involving pension funds

Summary - The Court of Appeal found that a scheme to defraud HMRC was not a 'sham'.

The allegations against the defendants were that two schemes were set up with the dishonest intention of securing the payment of income tax relief at source (RAS) from HMRC by paying the same amount into pension schemes repeatedly, each time triggering a payment by HMRC. This was achieved by arranging for the pension schemes to borrow and lend circularly.

Decision:

The court noted the 'curious' features of the scheme. For instance, because of the high rate of interest on some of the loans, the schemes were never going to generate a pension. The court observed, however, that the claims for RAS had been made in accordance with the specified statutory procedure by the duly appointed administrators of the registered pension schemes. Furthermore, the claims were made in respect of contributions which had taken place, as evidenced by the relevant bank accounts. The fact that those contributions were funded by loans was irrelevant. The court concluded that a high level invocation by the prosecution of the concept of sham was 'not good enough'. What was required was evidence, to the criminal standard of proof, that the contributions lacked any true legal substance. In this respect, establishing the common intention of all parties was key. The prosecution was not alleging that clients were implicated in the fraud.

Comments - The case contains a detailed analysis of the concept of 'sham', together with extensive reference to the relevant case law. It may, therefore, be relevant to anyone faced with an allegation that a transaction is a sham. It confirms, in particular, that a common intention of all the parties is key to the establishment of a sham.

R v Quillan and others [2015] EWCA Crim 538

Reduction of a penalty for error

Summary - The FTT reduced a penalty imposed by HMRC.

HMRC had imposed a penalty for an error in a VAT return. There were two issues: whether the error was 'deliberate and concealed' or just 'careless'; and whether the quality of the taxpayer's disclosure warranted a further reduction to the penalty (FA 2007 Sch 24).

Decision:

The FTT found that the error had been careless, rather than deliberate and concealed. Key to this finding was an invoice, which had been included in the return and which HMRC claimed was false. The FTT found that it had not been established that the director of Servbet had been aware of the fact that the invoice was only an estimate when completing the VAT return. However, the FTT also noted that the director should have made some enquiries, given the unusual nature of the invoice and the financial difficulties of the company. This meant that the error was careless and that the maximum penalty that could be imposed was 30%.

Finally, the FTT found that there had not been any significant delay by Servbet. Following an HMRC inspection on 12 January 2012, during which the validity of the invoice had been questioned, the director had written to HMRC on 14 February 2012 explaining that the invoice was actually an estimate. Servbet should therefore be given the benefit of the full 40% credit for 'helping'.

The FTT substituted a penalty of 18% of the full penalty to the 25% imposed by HMRC.

Comments - FA 2007 Sch 24 imposes a very mechanistic approach to the calculation of penalties. Taxpayers should therefore ensure that their failure is allocated to the right category.

Servbet v HMRC [2015] UKFTT 130

Unreasonable conduct

Summary – The Tribunal decided in favour of the taxpayer regarding costs for unreasonable behaviour

The taxpayers sought costs after their success before the First-tier Tribunal (TC3550). In its decision, the tribunal found that HMRC had failed to produce evidence of their assertion that the taxpayers had been negligent in relation to a tax planning scheme.

The main reason behind the taxpayers' claim for costs was that HMRC's conduct had been unreasonable.

Decision:

The First-tier Tribunal said it was clear from the notice of appeal that HMRC "were being put on strict proof of negligence" and this clearly required evidence. Without that evidence, there was no chance that HMRC could have succeeded in the appeal. It was the tribunal's opinion that it was unreasonable conduct on the part of HMRC to defend the appeal without intending to produce evidence to establish negligence. The judge said HMRC should therefore pay the taxpayers' costs.

Comments – Costs are awarded against HMRC in limited circumstances. These include unreasonable conduct. There are a limited number of cases where this has been successfully achieved. This case will now be added to the list for future reference.

R, A and M Gardiner v HMRC TC4320

Awareness of the penalty regime and reasonable excuse

Summary - The FTT found that being unaware of the penalty regime was not a reasonable excuse.

HMRC alleged that the taxpayer was late paying PAYE tax and National Insurance in nine months for 2012/13. They imposed penalties under FA 2009, Sch 56 against which the taxpayer appealed. It did not accept all the payments were late. It said the letter from HMRC advising that a penalty had been imposed was the first it had received on late payments and, had it received information earlier, it would have ensured payments were sent on time. The taxpayer added that payments were only a few days late and that it had not received employer packs about the penalty system.

Decision:

The First-tier Tribunal noted that HMRC accepted that the payment in month three was on time, so it allowed the appeal in respect of that month. That apart, the tribunal found:

- FA 2009, Sch 56 dictates the rate of penalty according to the number of late payments in the tax year;
- HMRC are not required to warn employers about the penalty system;
- lack of awareness of the system did not constitute special circumstance and a reasonable employer could not fail to have seen and taken note of the publicity provided by HMRC; and
- failure by the Revenue to issue warnings did not amount to a reasonable excuse.

The tribunal judge considered "on a balance of probabilities" that letters about the penalties had been sent to and received by the taxpayer. Further, the judge believed that HMRC warned about possible penalties in telephone conversations with the employer. He was also satisfied that the employer would have received employer bulletins and information about the Sch 56 regime before it came into force. Regardless of that, ignorance of the law was not a reasonable excuse for failing to pay tax on time. Finally, the tribunal decided that, in line with the decision in *CRC v Hok* [2013] STC 225, it had no jurisdiction to discharge a penalty because it was unfair. Even if it had, it would not have done so in this instance.

The taxpayer's appeal was dismissed except in respect of month three.

Comments - The taxpayer accepted that it was aware of the due date for payment. Therefore, the fact that he was not aware of the penalty regime could not constitute a reasonable excuse.

The Bunker Secure Hosting Ltd v HMRC TC4349

Validity of a notice of a requirement to give security

Summary - The FTT found that a notice of requirement to give security was valid, despite two failures by HMRC.

Mistral was appealing against a notice of requirement to give security (VATA 1994 Sch 11 para 4(2)(a)). The notice had been imposed because the business was 'deemed to pose a risk to future VAT revenue'.

Decision:

The FTT pointed to *John Dee* [1995] STC 941 as authority for the proposition that the FTT's role was to decide whether the decision to impose security was one that could be reasonably arrived at.

The FTT rejected Mistral's argument that HMRC should have taken into account the fact that it had changed its business model, in the absence of evidence to that effect submitted to HMRC. It found that HMRC had rightly taken into account the fact that Mistral's director had previously been the director of another company which had become insolvent, leaving a large tax debt. The FTT also pointed out that any allegations of involvement in MTIC fraud should have been disregarded by HMRC for these purposes. The FTT was satisfied that this had been the case.

The FTT noted that the fact that an appeal had been lodged against one of the assessments should have been taken into account. However, since the appeal had been withdrawn, this did not affect the reasonableness of HMRC's decision. Similarly, the fact that HMRC had failed to give reasons for its decision rendered it flawed; however, HMRC had subsequently adequately stated the reasons for its earlier decision.

Comments - HMRC's process in reaching its decision to impose a security was not perfect. However the FTT was persuaded that the defaults were minimal in that, without them, the same decision would have been reached. Alleging a process defect may not, therefore, always be sufficient against an otherwise valid decision by HMRC.

Mistral Promotions & Marketing v HMRC [2015] UKFTT 112

Confiscation order

Summary - The Court of Appeal dismissed an appeal against a confiscation order.

Both defendants had pleaded guilty to an indictment charging them with conspiracy to evade the duty payable on the importation of cigarettes (Criminal Law Act 1977 s 1(1)) and a confiscation order had been issued by the Crown Court under POCA 2002 ss 6 and 7. Both taxpayers were appealing against the confiscation order.

The plea of guilty to conspiracy did not itself constitute an admission that the duty had been evaded. The court therefore had to decide whether, on a balance of probabilities, the appellants had caused the goods to reach Felixstowe port (the duty point) and had kept the 'the required connection' with the goods when the vessel entered the port (The Tobacco Products Regulations 2001 reg 13).

The relevant authorities had received intelligence that a consignment of contraband cigarettes was due to arrive at Felixstowe. The appellants therefore contended that, at the moment the cargo entered the port, it was no longer possible for them to achieve the purpose of the conspiracy. The court found however that the conspirators had retained full control of the goods until HMRC's intervention.

The taxpayers also argued that the pecuniary advantage obtained by a criminal that evades a liability to pay excise duty but whose goods are seized has no 'value' (POCA 2002 s 76).

Decision:

Referring to *Smith (David)*[2001] UKHL 68, the court found, however, that if the defendants derived a pecuniary advantage in consequence of the evasion of a debt, even a 'fleeting advantage', they should be treated as having received that pecuniary advantage as property valued at the sum of the debt deferred. For the same reason, no breach of the European Convention on Human Rights (article 1 of Protocol 1) had taken place; the confiscation order was proportionate.

Comments - The logic of the appellants' arguments was compelling; they had lost control of the goods and, in any event, the evasion of excise duty on goods which have been confiscated did not represent a pecuniary advantage. The court found, however, that the appellants still had control of the goods at the duty point and that a 'fleeting advantage' was sufficient for the purpose of POCA 2002.

The Crown Prosecution Service v Robert Doran and Patrick Gray [2015] EWCA Crim 384

Deadline dates for May 2015

1 May 2015

- Payment of corporation tax liabilities for small/medium-sized companies with accounting periods ended 31 July 2014 where payment not made by instalments.
- £10 daily penalties apply to late online self-assessment tax returns for the year ended 5 April 2014 to a maximum of £900.
- New VAT fuel scale charges apply from today.

3 May 2015

- Filing date for form P46(Car) for quarter ended 5 April 2015.

7 May 2015

- Electronic filing and payment of VAT liability for quarter ended 31 March 2015.

14 May 2015

- Quarterly CT instalment for large companies (depending on accounting year end).
- EC sales list for quarter ended 31 March 2015 due (paper form).

19 May 2015

- Payment of PAYE/NICs/construction industry scheme/student loan payment liabilities for month ended 5 May 2015 if not paying electronically.
- File monthly construction industry scheme return.

21 May 2015

- File online monthly EC sales list.
- Submit supplementary Intrastat declarations for April 2015.

22 May 2015

- Electronic payment of monthly PAYE liability should have cleared HMRC's bank account.

31 May 2015

- Employees at 5 April 2015 and from whose pay tax was deducted should have received form P60 from their employers.

- Companies House should have received accounts of private companies with 31 August 2014 year end.
- Companies House should have received accounts of public limited companies with 31 November 2014 year end.
- HMRC should have received CTSA returns for companies with accounting periods ended 31 May 2014.

HMRC News

Tax changes coming into effect 1 April 2015

The following tax changes come into effect on Wednesday 1 April 2015:

- The Corporation Tax rate has been reduced to 20%
- The new Diverted Profits Tax has been introduced
- The bank levy has increased from 0.156% to 0.21%
- Air Passenger Duty has been restructured - abolishing bands C and D
- Hospice charities, blood bikes, search and rescue, and air ambulance charities will be eligible for VAT refunds
- Business rates changes (England only):
  - The business rates multiplier has increased from 48.2p to 49.3p (47.1p to 48.0p for small business multiplier). This includes the 2% inflation cap
  - The Small Business Rate Relief scheme has doubled for a further year - providing 100% relief for businesses with a single property with a rateable value of less than £6,000, and tapered relief with a rateable value of £6,000 - £12,000
  - The business rates discount for shops, pubs, cafes and restaurants with a rateable value of £50k or below has increased from £1,000 to £1,500
- The cultural test for high-end TV tax relief has been modernised and the minimum UK expenditure requirement for all TV tax reliefs has reduced from 25% to 10%
- A new tax relief on the production of children's television has been introduced
- The amount of banks' annual profit that can be offset by carried forward losses has been restricted to 50%
- Two new bands for the Annual Tax on Enveloped Dwellings (ATED) have been introduced
- Capital Gains Tax exemption for wasting assets will only apply if the corporate selling the asset has used it in their own business
- An investment allowance for North Sea oil and gas, replacing the existing offshore field allowances and simplifying the existing regime, has been introduced
- A reduced rate of fuel duty to methanol will apply - the rate is 9.32 pence per litre
- Fuels used to generate good quality electricity by CHP (combined heat and power) plants for onsite purposes are exempt from the Carbon Price Floor
- Climate Change Levy main rates have increased in line with RPI
- The VAT registration threshold has increased from £81,000 to £82,000 and the deregistration threshold from £79,000 to £80,000
- Scottish government's Land and Buildings Transactions Tax (LBTT) will replace Stamp Duty Land Tax in Scotland
- The associated companies rules have been replaced with simpler rules based on 51% group membership
- The standard and lower rates of landfill tax have been increased in line with RPI

Updates to FATCA reporting requirements

Ahead of the Foreign Account Tax Compliance Act (FATCA) return deadline of 31 May, two recent updates have changed the reporting criteria.

UK financial institutions are no longer required to file nil returns

Following a recent clarification from the US Internal Revenue Service(IRS) - see question C19 - HMRC has removed the requirement for nil returns from UK financial institutions.

Where a UK financial institution is in a nil return position through applying the de minimis $50,000 or $250,000 threshold on pre-existing accounts, it will still be necessary to submit a return in order to make the election.

Holding companies and treasury companies do not need to report under FATCA

New FATCA provisions mean that holding companies and relevant treasury companies are no longer defined as financial institutions.

This is consistent with the terms of the inter-governmental agreement between the UK and the US.

Unless such companies came within one of the other definitions of financial institution, they would have had nil to report in any event. They will now be classified as Non-Financial Foreign Entities, and either 'active' or 'passive', dependant on the activities carried out.

HMRC will be issuing further specific guidance for such entities shortly, which will be subsequently incorporated into revised guidance material to be published later this year.

Submitting your FATCA return

If you need to submit a FATCA return you will need to register and report by 31 May 2015.

To access the FATCA service you will need to create an 'organisation' type Government Gateway account, if you do not already hold one.

Once in the Government gateway, register for HMRC online services. FATCA is then listed as a service you can register for.

You must register 24 hours before submitting your FATCA return.

New version of Corporation Tax Return form introduced

HM Revenue and Customs (HMRC) has introduced a new version of the Company Tax Return form and its supplementary pages.

The new version of the Company Tax Return form (form CT600 version 3) must be used for accounting periods that start on or after 1 April 2015.

In addition, a new computation taxonomy has been introduced for computations that accompany the new CT600 form.

The old version of the CT600 form (version 2) and computation taxonomy must still be used for accounting periods that start before 1 April 2015, including accounting periods that span 1 April 2015.

Commercial software developers are aware of these changes and are updating their online filing products. HMRC's free downloadable filing software has also been updated. Please ensure that you are using software capable of producing the new version of the CT600 form and XBRL tagged computation for accounting periods that start on or after 1 April 2015.

Business Taxation

Venture capital companies and R&D relief

Summary - The FTT found that a substantial shareholder was a venture capital company, so that relief for R&D expenditure applied.

The appeals related to two claims by Pyreos for tax relief on expenditure on research and development by 'small and medium-sized enterprises' (CTA 2009 s 1119). As more than 25% of the share capital of Pyreos was held by Siemens Technology Accelerator (STA), the relief could only be available if STA was a 'venture capital company' (VCC), as this would mean that Pyreos was not a 'partner enterprise' for the purpose of the provision.

Decision:

The FTT observed that the overriding principle of the provision was that it was intended to benefit genuinely autonomous companies. The FTT added that it had not been referred to any definition of VCC. It construed it as a 'company whose interest is in maximising the financial return on its investments in new businesses and speculative ventures'. As such, the day to day executive management of its investment does not concern the VCC.

The FTT concluded that, on the basis of the evidence, STA met the criteria of a VCC. Its objective was to maximise the financial worth of the Siemens Group and all contracts between Pyreos and STA were at arm's length. Furthermore, the management of Pyreos was conducted independently of STA, and STA did not exercise any influence on its management.

Comments - As pointed out by the FTT, neither the relevant domestic provisions nor the guidance published by the EU contained a definition of 'venture capital company'. This was, however, a matter of judicial knowledge which the FTT sets out in detail, making this case a useful reference in this respect.

Pyreos v HMRC TC4328

No entitlement to goodwill

Summary – The Tribunal allowed the claim on loss relief but found there was no purchase of goodwill.

Spring Capital acquired a trade from an associated company (Spring Salmon) and claimed loss relief under CTA 2010, s 940A to s 953. HMRC refused the claim on the ground that the common ownership test had not been met. The company was also in dispute with HMRC about the amortisation of goodwill.

The taxpayer appealed.

Decision:

The First-tier Tribunal allowed the claim for loss relief in principle, subject to quantification of figures, and adjourned the appeals pending the determination of another appeal by the taxpayer. On goodwill the tribunal held that there had been no purchase of goodwill and thus the taxpayer was not entitled to the deduction which it had claimed for amortisation of the goodwill.

Comments – This is one of several appeals by Spring Capital and Spring Salmon. Many of these are listed in an appendix to the First-tier Tribunal decision in *Spring Salmon & Seafood* (TC4002).

Spring Capital Ltd v HMRC TC4273

EU law and the amortisation of goodwill in non-resident companies

Summary - The advocate general (AG) considered that the rules on the amortisation of goodwill, which differentiate between participation in resident and non-resident companies, are not compatible with EU law.

The issue was whether the Austrian provisions on the taxation of groups are compatible with EU law, as acquisitions in Austrian companies are treated differently from those in non-resident companies. Goodwill amortisation is only available within Austrian companies.

Decision:

The AG considered that this difference was potentially in breach of the principle of freedom of establishment. It robustly rejected the Austrian government's argument that this would not be an issue in situations where the goodwill is negative, noting that acquisitions of companies with negative goodwill are likely to be very rare. The AG also noted that, for these purposes, resident and non-resident subsidiaries are in objectively comparable situations; and that such a difference of treatment was not justified by the need to maintain the cohesion of the tax system.

The AG concluded that the measure in question contravened the principle of freedom of establishment.

Comments - The CJEU has already examined in detail the taxation of groups in France, Holland and the UK. This case will be the opportunity for the CJEU to review the taxation of groups in Austria. It remains to be seen whether it will find that the Austrian provisions are incompatible with EU law.

Finanzamt Linz v Bundesfinanzgericht, Aussenstelle Linz (C-66/14)

Deferral relief and cross-border reinvestment

Summary - The CJEU found that German provisions which only allow the deferral of capital gains tax in circumstances where the sale proceeds are reinvested in assets located in Germany are contrary to the principle of freedom of establishment.

Under German tax law, tax payable on the disposal of certain capital assets used in permanent establishments located in Germany can be deferred until the sale of the replacement assets; this is on the condition that the replacement assets form part of the assets of a permanent establishment also situated in Germany. Such deferral is therefore not possible if the assets belong to a permanent establishment situated outside Germany but within the European Union.

The European Commission sought a declaration from the CJEU that these provisions were in breach of TFEU (Freedom of establishment) art 49. It argued that an economic operator will take account of the fact that reinvestment outside Germany is less advantageous than reinvestment in Germany.

Decision:

Agreeing with the Commission, the CJEU found that the provisions hindered the freedom of establishment and went further than necessary. Allowing the deferral of tax in circumstances where the replacement assets are situated outside Germany would not force Germany to abandon its right to tax capital gains generated within the ambit of its powers of taxation. Taxable persons wishing to reinvest outside Germany should therefore be given the choice between immediate payment and bearing the administrative burden of deferral.

Comments - The discrimination was established, but the German authorities argued that it was justified to preserve their taxing powers and achieve their policy objectives. The CJEU robustly disagreed. The administrative difficulties, linked with the necessity of taxing assets situated outside Germany, did not justify this hindrance to the freedom of establishment. The policy objective of encouraging reinvestment could be achieved with cross-border investment.

European Commission v Federal Republic of Germany (C-591/13)

Trading or investment? (Lecture B891 – 10.26 minutes)

An answer to this perennial question was given in *Terrace Hill (Berkeley) Ltd v HMRC (2015)* which has recently been decided by the First-Tier Tribunal. The taxpayer company was involved in the development of a prestige office property in Mayfair which was subsequently disposed of and, as a result, there was a dispute with HMRC as to whether this represented a trading activity or whether the company had simply sold an investment. This is a familiar issue and, although the Tribunal said that the question was finely balanced, the judges ultimately found in favour of Terrace Hill (Berkeley) Ltd by agreeing that the property had been acquired as an investment.

The importance of this point is that the company had substantial capital losses which would eliminate any tax on the gain arising from the disposal of an investment. If the transaction had been treated as trading, the capital losses would have been of no immediate use.

The issue here was one of fact: when the property was acquired by the company in August 2000, was it intended to be retained as an investment or was it going to be sold shortly after the completion of the development for the best possible price?

The facts were lengthy and complicated, but the essential elements which persuaded the Tribunal that the acquisition was an investment rather than a trading purchase were the following:

(i) The accounting treatment of the property in the company's books was that of a capital asset – it was never held as trading stock.

(ii) The company had made a claim for capital allowances in respect of the property's plant and machinery content – this would only have been possible if the building had been an investment.

(iii) The evidence before the Tribunal was that, at the time of the acquisition, the property was intended to be an investment.

(iv) The detailed documentation was largely consistent with this point of view.

(v) The sale in 2005 was motivated by a disappointing initial rental performance (many prime American businesses, which might otherwise have been potential tenants, were less prepared to be based in London following 9/11), but it was the extremely attractive price offered which made the sale a virtual no-brainer.

A disturbing feature of the facts in this case is that HMRC had sought to impose a penalty of £1,000,000 on the taxpayer company on the ground that, by claiming investment treatment for the disposal, Terrace Hill (Berkeley) Ltd had been negligent. As you know, HMRC are presently consulting on the question of penalties and on how the system can be improved. Perhaps they should start by looking at this case. The proposition that expressing a view which is contrary to HMRC's own perspective is behaviour deserving of a penalty looks to be somewhat extreme. Fortunately, the Tribunal found that the company had not been negligent – indeed, they had been correct with their arguments – and that, even if the taxpayer had been wrong, there was no negligence in dealing with this matter.

Contributed by Robert Jamieson

Directors' remuneration strategy **(Lecture B892 – 8.36 minutes)**

Previously, when extracting profit from an owner managed company, salary would have been withdrawn at a level guaranteeing that no employee or employer national insurance was payable (2015/16 - £8,060). Gross dividends would have been extracted (2015/16 - £34,324) to ensure that taxable income was just below the higher rate threshold (2015/16 - £42,385) and so no higher rate tax was payable. Remember that at this level clients are still protecting their entitlement to future state pension and benefits.

However, adopting this low salary, high dividend strategy may mean that the small owner-managed business wastes the £2,000 employer national insurance allowance that now exists. By increasing the salary withdrawal to equal the personal allowance, a small amount of employee national insurance becomes payable but any employer national insurance is covered by the £2,000 employer national insurance allowance. Is this a beneficial strategy?

Increasing salary

If we take a salary equal to the personal allowance of £10,600 instead of the usual £8,060, taxable income will consist of the £10,600 salary plus gross dividends of £31,784 (£28,606) totalling £42,384. Again, this is just below the higher rate threshold of £42,385 and so no higher rate income tax is due.

Employees' NIC on the £10,600 salary will total £305 but no employers NI needs to be paid due to the £2,000 Employment Allowance.

This route incurs an additional £305 cost but saves corporation tax of £508 ((10,600 – 8060) x 20%).

Comparison

The overall tax and NIC savings of increasing the salary to £10,600 and reducing the gross dividends to £31,784 is £203 calculated as the additional corporation tax saving of £508 (£2,540 @ 20%) less the employees' NIC payable of £305.

This is a small saving but worth having for small businesses and could be doubled where both husband and wife work in the company, assuming that the higher salary is justified for both parties. Note that this route also allows for higher pension contributions if that is of interest to the client.

Transferable married couples allowance

From 6 April 2015 where one spouse or civil partner is not using their personal allowance they can transfer up to 10% of the allowance provided that neither party is a high rate taxpayer. So in 2015/16 this is worth £212, a small amount but still a saving that is worth having.

Where a director stays with the salary of £8,060 and only has basic rate dividends then they are not using their personal allowance as the dividend tax credit is not repayable.

If their basic rate spouse is employed outside of the owner managed company, then paying the lower salary of £8,060 means that some of the unused personal allowance can be transferred to the their spouse. This negates the benefit of increasing the salary to £10,600 when you have a basic rate spouse who could utilise the transferred allowance.

In deciding whether to take a salary of £8,060 or £10,600 clearly it is important to consider the employment and tax position of both parties.

Expenditure on R&D (Lecture B893 – 11.42 minutes)

In computing their taxable profits, small and medium-sized companies are able to claim a special enhanced deduction for qualifying R&D expenditure (see S1044 CTA 2009). With effect from 1 April 2015, the allowable deduction (often referred to as a 'super-deduction') has been increased to 230% of the relevant expenditure (S27(3) and (5) FA 2015). For a company paying corporation tax at 20%, this represents an effective tax relief of 46%.

For a company to be classified as medium-sized, it must have fewer than 500 employees and either a:

- turnover not exceeding €100,000,000 (roughly equivalent to £72,500,000); or
- gross assets total in its balance sheet not exceeding €86,000,000 (roughly £62,500,000).

In other words, such companies may still be very substantial enterprises.

If such a company has been making losses, it is able instead to claim a repayable R&D tax credit amounting to 14.5% of the lower of:

- its trading loss for the accounting period in question; or
- 230% of its qualifying R&D expenditure incurred in that period.

The repayable tax credit rate remains at 14.5% for the current financial year. However, because of the increase in the super-deduction, loss-making companies will now be entitled to a maximum cash rebate equal to 33.35% of their original expenditure.

Any company which does not meet the test above is classified as large. Large companies enjoy a less generous super-deduction. Since 1 August 2008, this has been set at 130% of their qualifying R&D expenditure.

However, in FA 2013, it was confirmed that large companies could claim an alternative form of R&D tax relief. This is known as an 'above the line' (ATL) credit and was initially given at 10% (see S104M CTA 2009). The ATL regime, which is currently optional, will replace the existing super-deduction framework for all large companies from 1 April 2016 onwards.

A key feature of the ATL credit, which is officially referred to as an 'R&D expenditure credit', is that it is treated as a taxable receipt and is paid net of tax to companies with no corporation tax liability. Effectively, it is like a grant. For a simple example of how it works, see the illustration below.

By virtue of S27(2) and (5) FA 2015, the rate of the ATL credit has been increased to 11% of qualifying R&D expenditure incurred by the company on or after 1 April 2015.

Illustration 3

Frederick Industries plc is a large company for R&D relief purposes. On the assumption that it has incurred qualifying R&D expenditure of 1000, the comparison below shows the difference between the super-deduction and the ATL systems:

		Current	ATL
Turnover		2700	2700
R&D expenditure		(1000)	(1000)
ATL credit			110
Other expenditure		(1200)	(1200)
		500	610
R&D relief	(30%)	(300)	
Taxable profit		200	610
CT @ 20%		40	122
ATL credit			(110)
Tax payable		40	12

The increases detailed above are being partially funded by a new measure which is applicable to all R&D schemes. With effect from 1 April 2015, expenditure will be excluded from a company's R&D claim if it relates to consumable items incorporated into products which are subsequently sold (S28 FA 2015).

Contributed by Robert Jamieson

Trade and asset transfers – streaming of losses (Lecture B894 – 14.55 minutes)

The First-Tier Tribunal decision in *Leekes Ltd v HMRC (2015)* relates to a company (L) which carries on a trade of running out of town department stores. On 18 November 2009, L purchased the entire share capital of another company (C) whose trade comprised the operation of three furniture stores plus some warehousing facilities. On the following day, C's business was hived up to L and C's stores, having been renovated and rebranded under their new owner's name, continued to sell the same types of products.

Unfortunately, the business of C had been loss-making and, as at 31 March 2010 (the first year end after the takeover), C's trading loss carry-forward amounted to over £3,000,000. L's corporation tax computation for the year ended 31 March 2010 showed an adjusted profit of more than £1,650,000 – none of this came from C. L claimed that this profit should be offset by an equivalent amount of loss relief. HMRC opened an enquiry into L's corporation tax return for this accounting period, the conclusion of which was the issue of a closure notice on 17 September 2013, disallowing the losses claimed. L then appealed to the First-Tier Tribunal.

HMRC accepted that L's enlarged trade was the 'same trade' as had previously been carried on by L and C respectively, but the dispute was all about whether the losses of the trade transferred in by C had to be streamed against that part of the profits made by L which resulted from the operation of C's 'old' trade. Because the former C activities did not contribute at all to L's profit for the year ended 31 March 2010, HMRC refused to allow any loss relief for that accounting period. Note that there was no argument about the quantum of the loss carry-forward – it was simply a question of whether any part of C's losses could be utilised in the year ended 31 March 2010.

The legislation under consideration is now found in Ss940A – 953 CTA 2010 (formerly Ss343 and 344 ICTA 1988). These provisions deal with the situation where one company transfers a trade or part of a trade to another company and, provided that there is no effective change of ownership, the trade is *not* regarded as having discontinued but rather as having been transferred to a successor. For the purposes of this relief, no effective change of ownership means that beneficial ownership of the trade was held as to 75% by the same person(s) at some time during the one year before the transfer and at some time during the two years after the transfer. In this case, the transfer referred to was the hive-up on 19 November 2009.

Where the trade transferred in is different from the successor company's trade (ie. it forms only part of that company's trading activities), S951 CTA 2010 requires it to be treated as a separate notional trade. Where necessary, the successor's receipts and expenses have to be apportioned so as to ensure a proper set-off of the transferor's losses (S952 CTA 2010).

In this context, note the High Court's decision in *Falmer Jeans Ltd v Rodin (1990)* where the loss claim was allowed, even though the profits of the transferred trade were, in the words of one commentator, 'no longer being separately realised'.

In the end, the Tribunal decided that the form of streaming referred to above is not necessary where a whole trade has been succeeded to. In other words, where, on a trade and asset transfer, there is a common identity of trade before and after the succession, there is *no* restriction of losses which can be offset against the profits of the (same) enlarged post-succession trade. HMRC accepted that the specific rules discussed above did not apply in the *Leekes* case given that the whole trade was transferred, but they considered that streaming was still implied by the general provisions of this part of CTA 2010 which restricted the loss relief to what the transferor would have been entitled 'had it continued to carry on (that) trade'. Incidentally, the wording in S944(3) CTA 2010 is identical to that used in S343(3) ICTA 1988, apart from the substitution of 'that' for 'the'. In HMRC's view, this meant that any loss relief was limited to the profits which the transferor company would have made had it continued the transferred trade (none in this case), whereas L argued that the provision only defined the amount of the available loss.

As previously indicated, the Tribunal preferred the taxpayer's interpretation. As a matter of commercial reality, there was, post-transfer, only one trade and so the Tribunal felt that any tax legislation which required streaming of the results of this combined trade would need to be explicitly stated rather than just being implied. In the words of one authority:

'The taxpayer's interpretation was more in line with commercial reality and gave rise to less need for the fictions that would have been necessary in order to trace the results of a trade that no longer existed separately.'

This is an interesting decision on the part of the First-Tier Tribunal which considers the legislation before the corporation tax rewrite in 2010, but it is clearly still relevant in the context of the revised consolidating statute.

Contributed by Robert Jamieson

VAT

Fleming claims and computational difficulties

Summary - The FTT dismissed an appeal against HMRC's refusal to make a repayment under a Fleming claim. The decision was based on the complexity of the calculation.

The case concerned a *Fleming* claim, calculated by reference to an extended period of 20 years from April 1974 to March 1994.

It was accepted that a substantial amount of input tax was repayable. The issue was merely computational.

Decision:

The FTT noted that marginal alterations of arithmetical formulae could result in very substantial changes in the net amounts calculated as repayable. Therefore, although the areas of dispute were limited, their implications in value were significant.

The FTT stressed that its jurisdiction was a 'full' jurisdiction; the determination of the sum repayable by HMRC. It could not, therefore, limit itself to a review of principles, leaving aside the arithmetical aspects for finalisation.

The FTT dismissed the appeal on the grounds that it was not able to compute the amount of the repayment, given the volumes of records; and the fact that calculations of the claim had continued during the course of the hearing, partly in response to HMRC's criticisms. The FTT observed, in particular, that the first stage of the calculations involved an apportionment between business and non-business activities. This had not been resolved. Moreover, no partial exemption special method (PESM) had been agreed with HMRC with regard to input tax which could not be attributed to specific supplies. The parties also disagreed on the way extrapolation from actual figures should be carried out.

Comments - Faced with the impossible task of computing the amount of the repayment that the claimant was entitled to, the FTT dismissed the appeal. The FTT stressed, however, that it had 'misgivings' in deciding to do so; and suggested that mediation may be better suited to resolving the dispute.

Greater Glasgow & Clyde Health Board v HMRC [2015] UKFTT 119

Supplies by golf club to members

Summary - The FTT found that a golf club selling food and drink to its members was not making supplies to itself.

The Royal Troon (RT) golf club was appealing against HMRC's refusal of a claim for repayment concerning output tax on food and drink. The issue was whether the club, which bought food and drink for the private needs of its members, acted in a private capacity as the final consumer, taking any supplies by the club to its members outside the scope of VAT. RT relied on the direct effect of EU law to assert that the application of UK law was incompatible with the Principal VAT Directive. The FTT therefore analysed the position both under EU law and under UK law.

Decision:

The FTT first noted that, under EU law, RT was making supplies for consideration; and the price paid by members was at the same rate as non-members. Furthermore, the supplies were made by a taxable person. All the assets of the club (an unincorporated association) were held by its members as joint property. By interposing a committee and employees between RT and its members, RT had made supplies between two entities possible. The fact that RT may not have intended to make a profit was irrelevant. The test was whether it carried out an economic activity and the supply to non-members suggested a 'business-like' manner.

Under UK law, the FTT found that the deeming provisions of VATA 1994 s 94(2) applied, so that there was a supply for consideration in the course of a business, which was deemed to include the provision by a club of the facilities or advantages available to its members. Consequently, RT acted as a taxable person when it acquired food and drink for its members; and so the Principal VAT Directive art 2(1) had been correctly implemented in UK law.

Comments - Situations where supplies take place between two very closely connected entities often lead to difficult VAT issues when the two entities are difficult to distinguish. Here, the FTT relied primarily on the interposition of a committee between a club and its members to find that the club was not making supplies to itself.

Royal Troon Golf Club v HMRC [2015] UKFTT 121

HMRC's ability to enter into binding agreements

Summary - The UT found that HMRC was bound by a contract with the taxpayer.

HMRC had paid £1.4m to Southern Cross for repayment of VAT and associated interest and now sought to recover it. Southern Cross contended that the repayment had been made under a binding contract.

There were three issues: (1) Did VATA 1994 s 80 bar HMRC from entering into a binding agreement with Southern Cross? (2) Would any compromise agreement have been ultra vires and so void? (3) Was a compromise agreement formed on the facts?

Decision:

In relation to (1), the UT found that s 80 did not bar HMRC from entering into a binding agreement to settle a claim. The UT referred inter alia to *DFS* [2002] EWHC 807 — which establishes that s 85 allows HMRC to enter into a binding agreement in the context of an appeal — and noted that there was no reason why such ability would not exist in the absence of an appeal.

As for (2), the UT again found in favour of Southern Cross. The fact that it was later established that the supply of dental nurses to dentists was standard rated and not exempt, as agreed by HMRC, did not make the agreement void.

Finally, in relation to (3), the UT found that the pattern of correspondence between HMRC and Southern Cross, viewed objectively, pointed towards a process of negotiation and, in the end, an intention to conclude a contractual agreement. The UT noted in particular the language used by the parties, for instance the use of expressions such as 'offer' and 'accept'.

Comments - The case is interesting on two grounds: firstly, it confirms that HMRC can enter into agreements relating to VATA 1994 s 80 repayments; and secondly (and perhaps most importantly), it suggests that such agreements are binding even if the position agreed by HMRC is then judicially found to be wrong.

Graham Elliott (Withers) said the decision 'is an important confirmation of the principle that when a taxpayer and HMRC sign off on a negotiated settlement, that should be the end of the matter'. He added: 'The law is in HMRC's favour by allowing them to recoup a refund, which creates uncertainty for taxpayers; but this decision limits HMRC's ability when the refund arises under a compromise agreement. That said, there remains doubt on the point when the cause of HMRC's change of heart arises from jurisprudence that existed at the time of the refund, and seems only to relate explicitly to cases where the contrary interpretation was established later. The decision takes steps in the right and fair direction, and reveals the fact that the law is nevertheless weighted unfairly in HMRC's favour.'

HMRC v Southern Cross Employment [2015] UKUT 122

Compulsory registration figures

Summary – The Tribunal found that HMRC's apportionment was in order to compute past VAT liabilities

The taxpayer operated a sandwich bar and café. She began trading in 1993 and, although her taxable sales exceeded the VAT registration threshold since 2000, she was not registered until HMRC identified the problem in 2011.

After discussions with the taxpayer, HMRC compulsorily registered her from July 2000. They did not assess VAT for the period July 2000 to April 2003 because in that time she traded as a sandwich bar only so most of her sales were zero rated as takeaway cold food.

After that date, HMRC based the split of zero and standard-rated takings based on her takings in August 2011. This showed that 72% of her sales were standard rated, and HMRC applied this percentage to the eight-year period to calculate output tax, giving credit for input tax as well.

The taxpayer appealed on the basis that a one-month representative period was not adequate to calculate an eight-year output tax liability. She argued that the split of standard and zero-rated sales should have been made over a complete season rather than a single month.

Decision:

The First-tier Tribunal said the assessments were made using figures reported in the taxpayer's self-assessment tax returns. The only use of the August figures was to apportion the standard and zero-rated sales. There would “almost certainly be seasonable variations” in the café business, and it seemed to the tribunal that August, as a summer month, would favour the taxpayer because there would be more cold sales.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, said: “It is disappointing that 11 years passed before HMRC identified that Mrs Sherratt should have been VAT-registered — and the bill issued to her (£60,034) would be a big hit to most small businesses. This case is a reminder of the important point that late VAT registration can be corrected by HMRC for up to 20 years, a much longer period than the four-year one for correcting errors that applies once a business is actually registered.”

Linda Sherratt trading as The Beeches v HMRC TC4290

Compulsory deregistration

Summary - The FTT dismissed an appeal against HMRC's decision to compulsorily deregister the taxpayer.

This was an appeal against HMRC's decision to compulsorily deregister the taxpayer on the basis that insufficient evidence had been produced of an intention to set up a business or to make taxable supplies. TL had applied to register online, describing its business as 'wholesale beer, spirits, wines and liqueurs, and business consultancy services'. The registered address was a residential property. The only two sales made by the taxpayer over a period of eight months were to persons known to its managing director and were for very small amounts. The managing director had attended wine fairs but 'nothing had happened' as a result. There also seemed to have been no follow up with potential purchasers and there had been no due diligence. Finally, the appellant was not able to provide a business plan or projections, and there was also no evidence as to a funding model or any market research.

Decision:

The FTT concluded that the evidence showed that the appellant's aspirations had not yet 'crystallised into anything that remotely resembled a business'.

Comments - Clearly, the taxpayer had had the vague intention of running a business. However, in the absence of concrete steps, this was not enough to justify VAT registration.

TL Step by Step v HMRC [2015] UKFTT 134

Allowance not a discount

Summary - The UT found that an allowance for a part-exchange car was not a discount on the replacement car.

The issue was the value of a supply of a car where the customer had provided a car in part-exchange and the vendor had paid a part-exchange price in excess of the value of the part-exchange car. The UT observed that the taxpayer's case depended on equating the open market value of the replacement car with the amount of an equivalent cash transaction. The cash price for the replacement car would be a discounted price which would represent its open market value.

Decision:

However, agreeing with the FTT, the UT found that the value of the replacement car should not be determined by reference to an equivalent cash transaction, but by reference to the actual transaction expressed in terms of a monetary value. The customer had chosen to provide part of the consideration by way of a part-exchange and the vendor had chosen to provide an over-allowance on the part-exchange car in preference to a discount on the replacement car. The effects of those choices could not be altered. The key question was therefore:

'What is the consideration in money which would be payable by a customer for the replacement car in the context of a part-exchange of the part-exchange car?' The UT pointed out that 'just as there is no unique or correct retail commercial price, so too there is no unique or correct consideration in money which would be payable by a customer in the context of a part-exchange'. There was therefore no scope for arguing that the value of the replacement car was anything other than the price agreed by the parties. The over-allowance was therefore immaterial in this respect.

Comments - The taxpayer's case was seemingly simple; the over-allowance on the part-exchange car amounted to a discount by the vendor. However, the UT found that the over-allowance could not affect the price of the car which had been agreed between the parties. According to the FTT decision, this was one of 50 related appeals worth a total of £33m.

N&M Walkingshaw v HMRC [2015] UKUT 123

MTIC fraud and input tax recovery

Summary - The UT found that the fact that missing trader intra-community (MTIC) fraud was not established did not preclude HMRC from denying the recovery of input tax.

S&I bought and sold mobile phones. HMRC had denied S&I the recovery of input tax on most of the phones, on the grounds that they had been purchased from a person that had fraudulently evaded VAT; and that S&I knew, or ought to have known, that the transactions were connected with fraud.

The issue was whether it could be found that a trader should have known of fraud when it was not proven that fraud did exist (as fraud had not been established in relation to some of the transactions).

Decision:

The UT noted the FTT's finding of fact that S&I's director had not directed his mind to the possibility of fraud having been committed, despite being aware of the existence of a 'grey market'. The UT also noted that it had not been proven that the relevant transactions were not connected to fraud. The UT concluded that at the time the transactions had taken place, S&I should have known that the only reasonable explanation for them was a connection with fraud. The fact that HMRC had subsequently been unable to establish fraud was irrelevant.

However, that FTT had been wrong in finding that S&I should have carried further checks 'down the chain', as this would have been a 'formidable task'.

Comments - This case provides yet another refinement to the 'knowledge test', in circumstances where a transaction is linked to MTIC fraud and HMRC therefore seeks to deny the recovery of input tax from a trader down the supply chain. It confirms that such denial is possible even if fraud is not established.

S&I Electrical Plc v HMRC [2015] UKUT 162

Was a partnership the recipient of legal services?

Summary - The FTT found that a partnership was not the recipient of services provided to its partners.

The decision was anonymised. The partnership comprised four partners, Mr A, Mr B, Mr C and Mr D.

Mr D was approaching the specified retirement age. Before he retired, he consulted solicitors, which wrote letters to Mr A, Mr B and Mr C. The solicitors alleged bad faith against Mr A and Mr B and required the dissolution of the partnership.

On receipt of the solicitors' letters, Mr A and Mr B had consulted the same firm of solicitors; and Mr C had chosen to instruct a different firm. HMRC had disallowed the input tax on the legal bills, on the basis that the solicitors' client was not the partnership.

Mr A, Mr B and Mr C contended, however, that the existing partnership was the client; or, alternatively, that a future partnership comprised of Mr A, Mr B and Mr C was the client. Both contentions were robustly rejected, as the solicitors could not have been advising the partnership in circumstances where its partners had opposing interests; and Mr C's solicitor did not act for Mr A and Mr B, so that a future partnership could not be its client.

Decision:

The FTT also noted that the partners had not exercised their power to contract on behalf of the partnership (Partnership Act 1890 s 5), as the engagement letters were addressed to the individual partners.

Additionally, it was not enough to show that the partnership benefited from the solicitors' services. Following *Airtours* [2014] EWCA Civ 1033 and *Redrow* [1999] UKHL 4, the partnership must be a party to the contract and it must be liable to pay the fees. The services were therefore not supplied to the partnership, regardless of the fact that it reimbursed the fees to its partners. Finally, the FTT added that as the invoices had been issued to the partners and not to the partnership, it did not hold a valid VAT invoice for the purpose of the VAT Regulations 1995.

Comments - This case is a useful example of the application of the principles established in *Redrow*. A taxpayer will not be the recipient of a supply, simply because it benefits from it.

A partnership v HMRC [2015] UKFTT 161

Default surcharge and late repayment by HMRC

Summary - The FTT confirmed a default surcharge.

Garland Hoff is a small tour operator, and its liability to VAT is calculated under the Tour Operators Margin Scheme (TOMS). It set up a subsidiary, Garland Hoff Travel, to operate trader to trader under TOMS. The two companies were not grouped for VAT purposes. HMRC had identified a management charge between the two companies on which VAT was due. This meant that Garland Hoff would pay the VAT, and that its subsidiary would repay it and reclaim the amount from HMRC.

Mr Garland had considered it prudent to wait to receive the repayment from HMRC before making the payment of VAT. On receipt of the repayment from HMRC on 6 May, Garland Hoff had immediately instigated payment by BACS, which had not reached HMRC until 12 May (payment had been due by 7 May). As Garland Hoff was already in a surcharge period, a surcharge payment was due (VATA 1994 s 59).

Decision:

The FTT confirmed the surcharge, noting that neither reliance on an HMRC payment, nor insufficiency of funds caused by HMRC's delay, could constitute a reasonable excuse.

Comments - The FTT had some sympathy for the taxpayer. In circumstances where previous HMRC repayments had gone 'awry', it was understandable that it preferred to wait to be in receipt of the monies. However, the law on surcharges did not allow for such delays.

Garland Hoff v HMRC [2015] UKFTT 141

Holding companies: acquisition costs

Summary - The advocate general (AG) considered that management holding companies should be able to deduct VAT on acquisition costs and that partnerships should be able to belong to VAT groups.

In both cases, a holding company had incurred input tax in relation to the acquisition of limited partnerships to which it provided management services for a fee. Both cases turned on the method for calculating the input tax deduction which a holding company is entitled to when purchasing shares in subsidiaries to which it is to provide taxable services.

Decision:

The AG noted that the CJEU had consistently held that management holding companies carry out an economic activity. He therefore considered that expenditure connected with capital transactions incurred by a management holding company has a direct and immediate link with that holding company's economic activity as a whole. Input tax on that expenditure should not therefore be apportioned between economic and non-economic activities. A secondary issue was whether the Sixth Directive art 4(4) (second para) precludes a member state from excluding partnerships from VAT groups on the basis that they do not have legal personality. The AG also had to consider whether a member state may require the relationship between the members of the VAT group to be a relationship of control and subordination. Both these requirements could only be justified by the prevention of abusive practices and of tax evasion. Finally, the AG considered that art 4(4) does not have direct effect.

Comments - If the CJEU does follow this opinion, the case could have important ramifications for holding companies, which may be able to deduct a higher proportion of input tax. The UK may also have to amend the VAT grouping provisions, which currently do not allow partnerships to be part of a group**.**

Beteiligungsgesellschaft Larentia + Minerva & Co v Finanzamt Nordenham (C-108/14) and Finanzamt Hamburg-Mitte v Marenave Schiffahrts (C-109/14)

Refusal to return a confiscated item

Summary - The FTT allowed an appeal against the Border Agency's refusal to restore a bag.

Mrs Smouha was appealing against the refusal by the Border force to restore a crocodile skin handbag. Mrs Smouha had ordered the bag online from a Japanese company, which had mentioned the requirement to obtain CITES certificates (under the Convention on International Trade in Endangered Species of Wild Fauna and Flora) and confirmed that it would obtain these. On the bag's arrival in the UK, the Border Force had advised Mrs Smouha that it was being detained, as its importation also required an import licence. Mrs Smouha had then applied unsuccessfully to the Animal Health and Veterinary Agency (AHVLA) for a retrospective import licence.

The FTT only had supervisory jurisdiction in this respect. It could only allow the appeal if the refusal to restore was unreasonable, applying the *Wednesbury* principle [1948] 1 KB 223. The Border Force would then have to make another decision (FA 1994 s 16).

The Border Agency officer observed that restoration would only be possible in 'exceptional circumstances' and that 'if there is no retrospective licence, there are no exceptional circumstances'. Furthermore, the officer applied the term 'exceptional' as it was understood by the AHVLA, and not as required under CEMA 1979 s 152, which allowed a much wider discretion.

Decision:

The FTT concluded that the officer's discretion had been fettered, which may explain why he had failed to take into account all relevant matters. In particular, he had not accounted for the facts that Mrs Smouha had no previous experience of such matters and had ordered the bag from a reputable company; and that the permit would have been granted had it been applied for on time, as the importation was perfectly legal.

Finally, it was the sender's responsibility to ensure compliance in any event. The decision was therefore both unreasonable and disproportionate.

Comments - This exhaustive review of the relevant international and domestic provisions established that the Border Agency officer had both misunderstood and misapplied the relevant law.

Sabine Smouha v The Director of Border Revenue [2015] UKFTT 147

The VAT exemption for postal services and private providers

Summary - The CJEU found that the provision of postal services by a privately owned 'universal service provider' should be exempt from VAT.

The European Commission sought a declaration that, by failing to exempt from VAT the supply of postal services (other than passenger transport and telecommunications services) and the supply at face value of postage stamps, the Kingdom of Sweden had failed to fulfil its obligations under the Principal VAT Directive.

The Kingdom of Sweden considered that since it had ended its monopoly in 1993, there had no longer been a 'public postal service' in Sweden; and so the VAT exemption no longer applied. The CJEU pointed out, however, that the term 'public postal service' covered both public and private operators; and that Posten AB had been designated as a 'universal service provider' in Sweden. It therefore supplied the 'universal postal service', which must be exempt from VAT.

Decision:

The CJEU rejected arguments to the effect that the exemption would distort competition, pointing out that Posten AB was subject to a specific legal regime as a universal operator.

Finally, and for the same reasons, the CJEU held that the supply of postage stamps should also be exempt.

Comments - The CJEU stressed that what mattered was neither the nature of the services provided, nor the fact that the operator was privately owned. The key was that the operator was classified as a 'universal service provider' subject to specific obligations.

European Commission v Kingdom of Sweden (C-114/14)

Approved excise warehousing and diverted goods

Summary - The UT found that the operator of an approved excise warehouse was liable to UK duty and VAT, due on goods which had left his warehouse and had not reached their destination in Spain.

TDG operated an approved excise warehouse where it stored goods under suspension of excise duty for both domestic and export markets. The dispute related to four consignments of alcohol allegedly bound for Spain, but which had not reached their destination. Under Directive 92/12, as TDG had guaranteed the payment of the excise duties, it was now liable for the duty under the Excise Goods (Holding, Movement, Warehousing and REDS) Regulations 1992. Under Regulation 4(2)(a), the excise duty point was the time when the goods had left the warehouse.

Decision:

The UT stressed that, following *Greenalls* [2005] UKHL 34, whether or not TDG was guilty of any wrongdoing was not relevant. Furthermore, Regulation 4(2) did not require HMRC to prove that the diversion had occurred in the UK; and TDG had not established that the goods had been diverted only after leaving England. UK duty was therefore due and HMRC could rely on TDG's records to assess the amount.

Finally, the UT found (again, applying *Greenalls*) that HMRC had been entitled to issue a duty assessment against TDG, even though others may be jointly and severally liable for the duty.

The UT's decision meant that HMRC was also entitled to assess TDG to VAT under VATA 1994 s 73(B), as TDG had accepted that the liability to VAT followed upon the liability for excise duty.

Comments - The taxpayer was liable to excise duty on the basis that goods had left his suspension warehouse and had not reached their destination in Spain. This was the case regardless of the facts that he was not guilty of any wrongdoing and that others may also be liable.

TDG (UK) v HMRC [2015] UKUT 167

Collection of tax by a third party

Summary - The CJEU found that court enforcement officers responsible for the collection of taxes should only be personally liable for failure to pay in circumstances where they have the legal means to carry out their obligations.

At the request of a creditor, Mr Macikowski, a court enforcement officer, had taken enforcement action against Royal sp., a taxable trader. As part of the proceedings, Mr Macikowski had seized immovable property belonging to Royal. The property had then been sold at auction in February 2007. In compliance with Polish law, Mr Macikowski had calculated the tax due on the sale, which had eventually been transferred to Mr Macikowski who had paid the tax.

The Polish tax authorities had ruled that Mr Macikowski was personally liable for the tax which had not been paid on time.

Decision:

The CJEU observed that the measures which member states may adopt to ensure the correct collection of tax and to prevent evasion must not go further than is necessary and must not undermine the neutrality of VAT. In this respect, the imposition of tax collection obligations on the court enforcement officer was not precluded by the VAT Directive. However, the court enforcement officer should only be liable to the extent that he had the legal means to enforce his obligations — without his liability depending on factors over which he had no influence, including actions or omissions by third parties. This was for the referring court to decide.

Comments - Many jurisdictions (including the UK) impose tax collection obligations on persons who are not taxpayers. This case confirms the extent of such obligations in the VAT context.

Marian Macikowski v Dyrektor Izby Skarbowej w Gdańsku (C-499/13)

Supplies by a landlord

Summary - The CJEU found that supplies provided together with the letting of immoveable property could be either separate or part of a single supply, depending on the circumstances.

The Wojskowa Agency is a Polish public body responsible for letting state immovable property. In this context, it resells supplies, including electricity, heating, water and refuse disposal. Tenants are charged in advance and the amounts are corrected at the end of the year to reflect use. The Polish tax authorities contended that those supplies were part of a single supply of immovable property and therefore subject to VAT.

There were two issues: (1) whether the supplies were made by the agency; and (2) if so, whether they were part of the supply of property or separate.

Decision:

Distinguishing *Auto Lease Holland* (C-185/01), the CJEU found that the supplies were made by the agency, as the tenants did not purchase them from third parties.

The CJEU noted that, under its own case law, supplies useful to the enjoyment of immoveable property could exist independently of the letting of immovable property or be inseparable from it, depending on the circumstances. In particular, if the tenant could choose the supplier, the services were more likely to be separate. However, if a property was offered as a whole with the supplies, for instance, a turnkey office, a single supply was more likely. In this case, the use of meters to determine the level of consumption suggested separate supplies, as did the itemisation on the invoices issued by the agency. It was, however, for the national courts to make the necessary findings of facts.

Comments - Although the CJEU did not come to a firm conclusion, it focused on the economic reason for the transaction from the point of view of the parties, and the content of the agreement itself**.**

Minister Finansów v Wojskowa Agencja Mieszkaniowa w Warszawie (C-42/14)

Reduced rating on energy saving materials (Lecture B895 – 8.04 minutes)

VATA 1994, Schedule 7A Group 2 has a 5% rate for the supply and fit of energy saving materials in residential accommodation (dwellings and relevant residential) but charitable buildings no longer qualify.

In the recent case of AN Checker Heating & Service Engineers a business tried to apply the 5% rate in part. The job was for the installation of a central heating system which happened to include some energy saving goods. Tribunal ruled that it was a single standard rated supply and that the 5% rate could not be applied in part.

This then prompts the question "Should we consider separate contracts to secure the 5% rate?"

<u>Envoygate case</u>

This case concerned the supply of box-sash windows with draught stripping which was held to be a mixed supply and the 5% rate <u>was</u> due on the draught stripping. The key to this case was that the two supplies were offered to the customer separately; box-sash windows with the option to have draught stripping. They might be installed in single operation but they were not so closely linked that they formed one supply that would be artificial to split. It helped in this case that some customers chose to have the draught stripping and some did not.

This case shows the advantages of structuring the quote and the contract carefully.

<u>Itchen Sash Window Renovations</u>

In this case the quote was structured correctly but invoiced as one. The Tribunal held that you can invoice for both jobs on one invoice but they must be clearly itemised.

So what are energy saving materials?

The supply and fit of the following items qualify as energy saving materials and are chargeable at the 5% VAT rate if separately contracted:

- Insulation for walls, floors, ceilings, roofs or lofts or for water tanks, pipes or similar
- Draught stripping for windows and doors
- Central heating system controls
- Hot water system controls
- Solar panels
- Wind and water turbines
- Ground source heat pumps
- Air source heat pumps
- Micro combined heat and power units
- Boilers designed to be fuelled by wood

The supply of the goods on their own would be at the standard rate. When they are supplied and fitted the 5% rate can apply.

Gaining a competitive advantage

There are situations where a builder may be able to arrange contracts so that the 5% applies:

- When a builder quotes for a loft conversion their quote could be split so as to allow the homeowner to do some elements of the work themselves. They would need to ensure that the "supply and fit" of loft insulation is shown as a separate option.
- A builder quoting for renovation work on a rest home that includes Group 2 items could offer to supply and fit these items separately either at the same time or at a later date.
- When a builder quotes for a job that includes solar panels, they could consider whether it would be better for the solar panels company to contract directly with the homeowner.