Tolley®CPD

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Summer Budget 2015

On 8 July 2015 the Chancellor presented his post-election Budget. His speech covered a wide range of issues including a number of tax and other proposals that are of particular application to taxpayers. This document item highlights those items most likely to be of interest to employers. For complete details of the whole Budget see the document published by HM Treasury and HMRC.

There is also to be a second Finance Bill this year, which is due to be published on Wednesday 15 July, although its Parliamentary stages will not be completed until the Autumn.

Income Tax (Lecture P901 – 11.14 minutes)

Rates and allowances

The rates and allowances in force for the current year remain unchanged. The Budget includes a commitment (known as the 'tax lock') that the Government will legislate to limit the main rates of income tax, the standard and reduced rates of VAT, and employer and employee (Class 1) NICs rates, ensuring that they cannot rise above their current (2015-16) levels for the duration of this Parliament.

There are some changes to the previously announced allowances and thresholds for 2016/17. The personal allowance for 2016/17 will be £11,000 (rather than £10,800 previously announced) and the point at which the 40% rate band kicks in will be £43,000. The Chancellor also mentioned an aspiration to see that personal allowance reaching £12,500 by the end of this Parliament.

National Insurance

The only change to previously announced rates and thresholds is that the Upper Earnings Limit (above which an employee's Class 1 contributions drop to 2%) will increase to £43,000 for 2016/17 to match the 40% income tax threshold. Included in the 'tax lock' commitment mentioned above, is an assurance that for any tax year until the end of this Parliament, the Upper Earnings Limit will not be higher than the 40% income tax rate threshold.

From 6 April 2016, the rate of the annual employment allowance will increase from £2,000 to £3,000.

Dividend tax reform

In a surprise announcement, the taxation of dividends received by individuals is expected to be reformed from April 2016. The dividend tax credit is to be abolished and the first £5,000 of dividend income will be tax-free (seemingly irrespective of the marginal tax rate of the recipient, unlike the new personal savings allowance which will also apply from April 2016, as announced in Budget 2015).

The dividend tax rates are expected to be revised as follows:

- dividend ordinary rate will be 7.5% (up from a current effective rate of 0% once the dividend tax credit is taken into account)
- dividend upper rate will be 32.5% (up from a current effective rate of 25% once the dividend tax credit is taken into account)
- dividend additional rate will be 38.1% (up from a current effective rate of 30.56% once the dividend tax credit is taken into account)

Although not limited to business owners, it is expected that the dividend tax allowance and reform of the dividend tax rates will have the greatest impact on the owner-managed companies who take low salaries and high dividends. Based on the expected rates above, it is worth considering whether dividend payments should be accelerated and paid in 2015/16 to take advantage of the lower effective tax rates. You will need to take into account all the facts, including the impact of the £5,000 dividend tax allowance and the distributable reserves within the company.

Company car and van benefits

The Budget did not include any changes to the previously announced figures for company car or van benefits.

Tax credit regime

As was expected, the Chancellor announced a number of changes to the tax credits regime which will take effect from April 2016:

- the income threshold is to reduce to £3,850 (from £6,420)
- the income disregard for increases is to reduce to £2,500 (from £5,000)
- the taper rate is to increase to 48% (from 41%)

In addition, no child element will be payable for third and subsequent children born after 6 April 2017. Changes will also be made to the debt recovery rules to allow overpayments of working tax credit (WTC) to be recovered from child tax credit (CTC) payments and vice versa.

New National Living Wage

The Chancellor used the Budget to unveil plans for a new National Living Wage, which will work alongside the National Minimum Wage (NMW) and be compulsory and will work in much the same way as the NMW, but with application only for employees who are 25 or over.

It will start in April 2016 at a rate of £7.20 per hour but as with the NMW, it will be reviewed annually and the Government's intention is that it should reach at least £9.00 per hour by 2020.

Tax-free childcare

The Chancellor confirmed that the new system of tax-free childcare will now be introduced from early 2017. The existing limited exemption for employer-provided childcare will remain open to new entrants until the new system is in place, from which time it will only be available to employees already within an employer's scheme.

Student loans

From the 2016/17 academic year, maintenance grants will be replaced with maintenance loans for new students from England, paid back only when their earnings exceed £21,000 a year. At the same time, the maximum level of maintenance loan support will increase to £8,200 a year for students studying away from home, outside London.

The Government is also considering freezing the £21,000 repayment threshold for five years and is reviewing the discount rate applied to student loans. It will publish a consultation on its proposals in due course.

Pensions

Reform of the pensions system

In a surprise announcement, the Chancellor announced a high-level consultation on pension tax relief which proposes to turn the EET principle (exempt-exempt-taxed) on its head. Instead of receiving tax relief on contributions, tax-free growth in the fund and being taxed on extraction on retirement, the Chancellor envisages a regime built on TEE (taxed-exempt-exempt). This would work like more like an ISA, with no tax relief on contributions, tax-free growth in the fund (plus a "[G]overnment top-up") and tax-free at extraction.

There are a number of issues which the Government will need to address including:

- employer contributions (including the national insurance contributions implications)
- how to deal with the value of contribution for defined benefit schemes
- transitional provisions in relation to taxpayers who have accumulated pension savings under the EET principle

Annual allowance

From April 2016, the annual allowance is to be tapered for individuals whose annual income is more than £150,000 (including their own and their employer's pension contributions). The annual allowance (currently £40,000) will be reduced by £1 for every £2 of the excess over £150,000 down to a minimum of £10,000. It will not apply to anyone whose income, excluding pension contributions, is less than £110,000.

This means that anyone earning £210,000 or more (including pension contributions) can only get tax relief on £10,000 worth of pension contributions.

The current rules for the annual allowance work by reference to pension input periods, rather than by reference to a tax year. However the proposed taper will work by reference to tax years and therefore the legislation to be included in Finance (No 2) Bill 2015 will include measures to align the pension input period with the tax year.

The broad outline is that any existing pension input periods will be treated as ending on 8 July 2015, a new pension input period will run from 9 July 2015 to 5 April 2016 and subsequent 12 month period will then be aligned with the tax year. HMRC has prepared a technical note showing how it expects those alignment rules to work.

Lifetime allowance

As announced at Budget 2015, the lifetime allowance will reduce from £1.25m to £1m from 6 April 2016. Protection will be available for those with pension pots in excess of £1m at 6 April 2016.

Property income

Relief for mortgage interest

In a controversial move, the Chancellor announced that tax relief on the finance costs of landlords will be restricted to the basic rate of tax. Although this primarily relates to mortgage interest and mortgage arrangement fees, it also includes any interest paid on loans used to buy furniture or fixtures.

The measures appear to:

- apply to individuals only, not trustees or corporate landlords
- apply to interest costs associated with residential properties, not commercial property
- not apply to furnished holiday lets

The provision will be phased in over a four-year period, beginning in April 2017:

Tax year	Amount of total interest cost eligible for full deduction against rental income	Amount of interest where relief restricted to basic rate relief
2017/18	75%	25%
2018/19	50%	50%
2019/20	25%	75%
2020/21	0%	100%

The mechanism by which the tax relief will be restricted appears to be rather awkward and is best illustrated by a basic example.

If a higher rate taxpayer receives rental income for the 2017/18 tax year of £10,000 and incurs interest costs of £8,000, ignoring other expenses the calculation will be:

	£
Rents	10,000
Less: interest eligible for full relief (£8,000 x 75%)	(6,000)
Property income	4,000
Tax thereon:	
£4,000 x 40%	1,600
Less: interest restricted to basic rate relief ((£8,000 x 25%) x 20%)	(400)
Tax due	1,200

Effectively the interest is treated as a Step 6 tax reducer for the purposes of the ITA 2007, s 23 tax calculation. The tax reducer is 20% of the lower of the:

- finance costs which are not eligible for a full reduction in the calculation of the property income for the year
- property income for the year, or
- total taxable income (excluding savings and dividend income)

Any excess finance costs may be carried forward to following years if the tax reduction has been limited to 20% of the profits of the property business in the tax year.

It will be interesting to see analysis from economic experts as to the impact this may have on the housing market and rental market, as some landlords may sell properties which are uneconomic without full interest relief, whereas others may try to increase the rents to compensate for the tax changes. However, as it appears that this provision is not going to be subject to consultation and will be legislated in Finance (No 2) Bill 2015, there is little opportunity for interested parties to make representations.

Abolition of wear and tear relief

Wear and tear relief, available to those letting furnished residential property, is to be abolished from April 2016. It is to be replaced with a new relief which allows a deduction based on the "actual costs of replacing furnishings".

Although a technical consultation is to take to place in the summer, it appears that this is the reintroduction of the old non-statutory renewals basis.

The withdrawal of the non-statutory renewals basis from 6 April 2013 took most landlords and advisers by surprise as it was a by-product of the legislation of the wear and tear allowance and the removal of the extra-statutory concession which covered both provisions. It also led to confusion about which costs could be deducted from property income and which could not.

The cost of the original furnishing is not expected to be allowable and the definition of furnishing will be key. The advice to clients who currently benefit from the wear and tear allowance will be to try and avoid replacing such items before 6 April 2016.

Rent-a-room relief

Rent-a-room relief has remained frozen at £4,250 since 1997 and is unlikely to fully cover the rent of individuals letting a room in their own home in London or the South East. The Chancellor announced that the relief will increase to £7,500 from 2016/17 (implemented via secondary legislation).

Non-Domiciliaries

Overview

Before the General Election, the Labour party generated front page headlines by announcing that, if elected, it would abolish the favourable tax treatment enjoyed by non-domiciliaries.

Whilst Labour did not win the election and non-domiciliary status remains, the Chancellor announced three fundamental changes to the current regime which will be subject to consultation. These involve deeming an individual to be UK domiciled for tax purposes even though he may be non-domiciled in the UK under general law. The rules will apply for income tax, capital gains tax and inheritance tax.

From 2017/18 it is expected that an individual will be deemed UK domiciled:

- if he has been UK resident for at least 15 out of the last 20 tax years (note that the existing 17 out of the last 20 year IHT rules will be harmonised)
- for five tax years after leaving the UK and becoming non-resident if he acquired a deemed domicile under the 15 year rule
- if he had a UK domicile of origin, subsequently left the UK and acquired a non-UK domicile of choice and later becomes resident in the UK (referred to as the 'returning UK dom' by the technical briefing)

As a result of these changes to the rules for non-domiciliaries, the Government is **not** going ahead with the planned three year minimum claim period for the remittance basis charge which had been announced in Autumn Statement 2014.

15 year rule

When it comes to determining whether the test is met, the Government is undecided on whether split years will be treated as full years (as they are for the purposes of the remittance basis charge, see RDRM32220). There is no mention of whether a tax year in which the individual is dual resident will be counted for this test.

The existing rules for IHT in IHTA 1984, s 267(1)(b) will be amended to match the 15 out of the last 20 tax years rule (down from 17 out of the last 20 tax years). Once the individual is deemed domiciled under this rule, he will remain so even after leaving the UK and becoming non-resident. He only loses the deemed UK domicile status after having been non-resident for five tax years.

The 15 year rule will mean that the new £90,000 remittance basis charge for individuals who have been UK resident in the UK for 17 years or more out of the last 20 years, which applies from the 2015/16 tax year, will become redundant from 2017/18. This is because, under these proposals, such individuals will not be eligible to use the remittance basis. However, potentially individuals with unremitted income and gains of less than £2,000 will be able to retain the use of the remittance basis under de minimis rules.

Although these proposals will be subject to consultation, the technical briefing states that there will be **no** grandfathering provisions for individuals; these rules will apply to existing non-domiciliaries from 2017/18. There may be transitional rules for trusts.

Five year rule

Although the five year rule will apply for income tax and CGT as well as inheritance tax, since domicile status is not a factor in the calculation of the UK liability to income tax and CGT for non-residents, in practice this will only be relevant for inheritance tax purposes.

Existing three year rule for IHT purposes

The current three year rule for IHT is to be retained alongside these new rules, but will only apply to IHT.

The existing three year rule, which deems someone to UK domiciled if they have been UK domiciled under general law at any time in the previous three tax years, is subtly different from the proposed five year rule.

The three year rule applies independently from the current 17 out of the last 20 years rule and the UK residence status is irrelevant; an individual could be caught by the three year rule even if he has been non-resident for a long time since it depends on him relinquishing his UK domicile status under a domicile of choice, rather than simply leaving the UK.

Returning UK domiciliaries

The taxpayer's intention is irrelevant for this test; it applies equally to returners who emigrated from the UK a long time ago as it does to those who have tried to shed their UK domicile status for the purpose of avoiding UK tax.

This rule is intended to apply to all returning UK domiciliaries who arrive back in the UK after 5 April 2017.

Domicile status of children of deemed UK domiciliaries

An individual's deemed domicile does **not** affect the domicile status of his children under general law. Children of a father non-domiciled in the UK by general law will also be non-domiciled, even if the father is deemed by these rules to be UK domiciled. The child's domicile status is then assessed independently, such that once the child has been UK resident for at least 15 out of the last 20 tax years he would be deemed to be domiciled in the UK.

Venture capital schemes

These proposals are largely based on those announced at Budget 2015, though revised legislation will be available in the Summer Finance Bill to take into account the consultation response issued in July 2015.

Practically speaking, most are to ensure ongoing State aid approval of these schemes and add further tests and considerations for investors.

The proposals are:

- the investment must be made with the intention to grow and develop a business
- all investors must be independent from the company at the time of its first share issue
- a new qualifying criteria to limit relief to 'knowledge intensive' companies within 10 years of their first commercial sale, and other qualifying companies within seven years of their first commercial sale; but no age limit will apply if the total amount invested is equivalent to more than 50% of the turnover averaged over the preceding five years
- a restriction to prevent EIS and VCT funds being used to acquire existing businesses (including shares) and extended to non-qualifying holdings for VCTs

An overall cap will apply to the amount that a company can receive in total funding from both VCT and EIS investments in addition to the £5m annual cap. That cap is to be £12m for most companies although this will be £20m for knowledge intensive companies.

Another variation from the normal VCT rules to be introduced for knowledge intensive companies is that they will have an employee limit of 499 employees rather than the usual 249.

Also from 6 April 2014, EIS relief of investors in companies that redeem the shares of SEIS investors will no longer be reduced, so long as the SEIS relief on redeemed shares is repaid.

In addition, a clarification has been made to put beyond doubt that farming outside the UK is not an eligible activity.

The final proposed change is, from 6 April 2015, the requirement that the company must spend 70% of any money raised under the Seed Enterprise Investment Scheme (SEIS) before seeking EIS or VCT funding will be removed enabling simultaneous investment.

These provisions are likely to have effect from Royal Assent (except where stated above), are all subject to state aid approval, so are likely to be retroactivated when this is obtained.

Capital taxes (Lecture P902 – 8.41 minutes)

Increased IHT nil rate band for main residence

The Chancellor confirmed in his Budget speech the pre-announced proposal to introduce an additional IHT nil rate band (NRB) for the main residence. It will be available with effect from 6 April 2017 when a residence is passed on death to one or more direct descendants, such as children or grandchildren. Direct descendants include a step-child, adopted child or foster child.

The extra allowance will be phased in as follows:

Tax year	Additional NRB
2017–18	£100,000
2018–19	£125,000
2019–20	£150,000
2020–21	£175,000

The basic nil rate band will now remain at £325,000 until 5 April 2021, and thereafter the two elements of the NRB will increase together in line with the Consumer Price Index.

The main residence NRB will be transferable to a surviving spouse or civil partner, in the same way as the existing nil rate band. Hence the Chancellor was able to claim that the effective inheritance tax threshold for a couple will rise to £1 million in 2020/21. It will be 'transferable' even where the first death occurs before 6 April 2017, and the second death occurs afterwards. It appears that where the family home has been left to the spouse or civil partner on the first death at any time before 6 April 2017, the additional NRB is effectively backdated.

The sting in the tail, which was not pre-announced, was that the additional NRB will be progressively withdrawn for estates valued at more than £2 million. It will be tapered away by £1 for every £2 that the net value of the estate exceeds that amount (after deducting liabilities but before reliefs and exemptions), so the relief is aimed squarely at the moderately wealthy, who hold a large proportion of their wealth in their home, and will not benefit the very rich.

The relief applies to the deceased's interest in a residential property which has been his or her residence at some point and is included in the estate at death. Where more than one residential property qualifies, the personal representatives will be able to choose which one should attract the additional NRB. Clearly the choice will be governed by the comparative values of the properties and who the beneficiaries are. Case law relating to CGT private residence relief on what constitutes a 'residence' will be persuasive.

It is not clear from the information available whether the residence in question must be the subject of a specific gift to direct descendants, or whether the value can be included as part of a residuary gift to them. If a specific gift is required, most people hoping to benefit from the relief will need to draft or re-draft their wills. If, as is more likely, a gift of residue will qualify, the calculation of the NRB could be complicated where other beneficiaries, such as an unmarried partner, take a share of the estate.

It has been argued that the proposal to focus the increased NRB on the family home will encourage people to retain their wealth in their home and this could have a detrimental effect on the property market. As a result, the government is proposing to include measures which preserve the relief even if the testator has downsized to a less valuable residence, or ceased to own a residence after 8 July 2015. The aim is to apply the additional NRB to the value of the former home. In recognition of the technical challenge inherent in such a solution, the government will publish a consultation on the proposals in September 2015.

As proposed, the additional NRB will only be available on death. It will not apply to lifetime transfers that become chargeable on death. This is a strange detail which will, if enacted, work against the downsizing principle as it will tend to deter parents from making lifetime gifts to their children for fear of being caught by the 'seven year rule.' They may downsize because they need a smaller home, but they will be encouraged to keep the excess proceeds to benefit from the additional NRB.

The published proposals do not address the potential issue of 'upsizing.' By singling out one particular asset for special relief, parents and grandparents will be encouraged, as far as practicable, to concentrate as much as they can afford in the value of their home — if only temporarily!

Initial legislation will be included in Finance (No 2) Bill 2015, but the adjustments relating to downsizing and possibly other refinements will be deferred until Finance Bill 2016 after consultation.

Finance (No 2) Bill 2015 will include the promised provision to reduce the taxation of residual pension funds on death. Instead of the current rate of 45% which applies when someone dies at age 75 or over, the lump sum will be taxed at the recipient's marginal rate. These provisions illustrate the contrasting treatment of pension funds on death and other types of investment. Assets held outside of a pension fund are subject to IHT rules with the rate of tax being determined by the status and wealth of the deceased. Pension investments will be subject to income tax rules with the rate of tax depending on the level of income of the recipient and the period over which it is withdrawn. Given the potential to switch assets into and out of pension funds, there is scope for estate planning which makes best use of individual circumstances.

IHT and Non-domiciliaries (Non-doms)

In summary, a UK resident will become 'deemed UK domiciled' for all tax purposes if:

- •he has been UK resident for at least 15 out of the last 20 tax years, or
- •he had a UK domicile of origin, subsequently left the UK and acquired a non-UK domicile of choice and later returns to the UK

This means that the IHT deemed domicile rule which currently applies to those who have been resident for 17 out of the last 20 years will, with effect from 6 April 2017, apply to the shorter residence period of 15 years.

There is a further tightening of the rules for IHT purposes relating to those who leave the UK. Currently, a UK domiciled resident remains deemed domiciled for three years after leaving the UK, and one who has become deemed domiciled because of the 17 out of 20 years rule, must wait four years before losing the status. The new proposal is to extend that period to five years for a resident who leaves the UK.

The government will consult on the potential effects of these changes on the spousal election for UK domicile.

By increasing the scope of the deemed domicile rules, the government will widen the net for inheritance tax although the main targets for the changes are income tax and capital gains tax.

Non-doms will still have the opportunity to create excluded property trusts before becoming deemed domiciled under the 15 year rule. The trust itself will retain its general IHT exemption but there will be a new limitation relating to UK residential property (see below). Provided that the excluded property trust is also non-resident, it will not be subject to UK income and capital gains tax. However, the loss of non-dom status after 15 years for a settlor or beneficiary will result in his being taxed on the worldwide income or gains, and not just on those remitted.

In addition, the returning UK domiciliary, that is one who has acquired a foreign domicile but returned to the UK, will become UK domiciled again once he becomes UK resident. He will not be able to benefit from any favourable tax treatment of trusts created while he was a non-dom. In other words, excluded property trusts will never be available to those who were born with a UK domicile and return to the UK.

The government recognises that this is an extremely complex area and the new rules will be subject to consultation.

IHT rules on UK residential property

The Chancellor announced a further restriction to the advantages of non-dom status relating to UK residential property. A common tax planning technique for non-doms is to hold their UK property in an offshore company or partnership. By so doing, the UK situs asset is converted to excluded property because the asset becomes shares in an overseas company. As a result the non-dom avoids IHT on his residence in the UK because he is not subject to IHT on excluded (ie non UK) property.

A further refinement of the plan is for an excluded property trust to hold the shares of the offshore company that owns the property so that the exemption is retained after the individual has become deemed domiciled.

A technical briefing explains how this advantage will be curtailed. The rules will be amended so that all UK property will be subject to IHT in the same way that it applies to UK domiciled individuals.

Legislation will provide that offshore companies or similar structures are not excluded property to the extent that they derive their value directly or indirectly from UK residential property. As a result, IHT on death will apply and relevant property charges will apply where the property is held in trust.

Again, the issue is highly complex potentially involving other taxes such as ATED, CGT and SDLT. A consultation will be published inviting views and representations. The intention is to make the changes effective on or after 6 April 2017.

Changes to IHT charges on trusts

The original draft Finance Bill 2015, published in December 2014, included legislation designed to counter pilot trusts, and revised the rules relating to the charges on relevant property trusts. The proposals were not included in the curtailed Finance Act in March 2015, but they will be introduced in Finance (No 2) Bill 2015.

The calculation of IHT principal and exit charges will be simplified by removing the requirement to include non-relevant property in the initial value to determine the rate of tax. This is a welcome amendment in light of the difficulty of obtaining historic valuations, particularly where, as in old Accumulation and Maintenance trusts, an initial value was not required when the trust was created. The new rule will apply to all charges arising on or after the date of Royal Assent regardless of when the trust was created.

In relation to pilot trusts, it is proposed that the calculation of 10 year and exit charges will take account of 'same-day additions'. This means that where property is added on death to multiple trusts, (ie previously created pilot trusts), the calculation will effectively combine it into one trust, thus losing the benefit of multiple nil rate bands. The measure will apply to charges arising on or after the date of Royal Assent, but only to relevant property trusts or additions made on or after publication of the original draft legislation on 10 December 2014.

The new rules are disapplied to a will executed before 10 December 2014, where the death occurs before 6 April 2017.

Income tax and trusts

As already covered, changes were announced to the taxation of dividends for individuals. The tax credit is to be abolished and individuals will benefit from a Dividend Tax Allowance of £5000. Dividend income above the allowance will be taxed at 7.5%, or 32.5% or 38.1% according to the individual's personal rate of tax.

There is no mention of how this new system will apply to trustees. The worst case scenario is that a rate of 38.1% will apply to all dividends received by discretionary trusts (following the alignment of the trust rate with the individual additional rate). Presumably, the tax paid, at whatever rate, will go into the tax pool and become potentially repayable, thus changing the issues of a mismatch of tax rates in the tax pool.

Corporation and Business income Tax (Lectures B901/ 902 – 11.35/ 9.46 minutes)

Corporation tax rate cut

The main rate of corporation tax for non ring-fenced profits has been cut over the past few years from 28% for the financial year (FY) 2010 down to 20% for FY 2015. To encourage further inward investment in to the UK, the Chancellor announced today that the main rate will be reduced further to 19% for FYs 2017, 2018 and 2019. It will be reduced by an additional 1% to 18% for FY 2020. The legislation for these changes will be included in Finance (No 2) Bill 2015.

In addition to the impact on cash flow forecasts, companies will in time need to calculate the impact these changes will have on the value of deferred tax assets and liabilities in their financial statements.

CT payment dates

Large companies are required to pay their UK corporation tax liabilities in quarterly instalments, with the first instalment normally being due 6 months and 13 days after the start of the accounting period. This is later than in most other G7 countries, and later than the payment of UK income tax by most individuals. The Chancellor announced today that the instalment payment dates will be brought forward for the largest UK companies, Ie those with profits over £20 million. For groups, the £20 million profits threshold will be divided by the number of companies in the group. The government will publish draft legislation in the autumn, and it is expected that the measure will apply to accounting periods commencing on or after 1 April 2017. The instalments will be due in the third, sixth, ninth and twelfth months of the accounting period. The changes will help to ensure that tax payments are made closer to the point at which profits are earned, and brings the UK in line with most of the other G7 countries.

CFCs loss restriction

The controlled foreign company (CFC) legislation levies a charge on a UK company in relation to profits generated by its controlled foreign companies (CFCs) which have been diverted from the UK. UK tax losses can be used to reduce the amount of the CFC charge, thereby reducing or eliminating the UK corporation tax liability in respect of those profits. This is done by offsetting the tax value of the losses against the CFC charge itself.

It was announced today that brought forward, current year and group relieved losses and management expenses will no longer be available for use in this way, following the repeal of TIOPA 2010, s 371UD. This measure has immediate effect, applying to profits generated on or after 8 July 2015. For accounting periods which straddle this date, CFC profits should be apportioned on a just and reasonable basis to ensure that losses and management expenses can still be offset against profits arising prior to the commencement date. Interestingly, the apportionment is not carried out on a time apportionment basis, which could allow some degree of flexibility for companies which see seasonal fluctuations in profits.

Transfers of trading stock and intangible fixed assets

Transfers of trading stock or intangible fixed assets (IFAs) between related parties typically take place at market value for corporation tax purposes, in accordance with the provisions of CTA 2009, Part 3, Chapters 10 and 11, and CTA 2009, Part 8, Chapter 13 respectively. However, the transfer pricing legislation set out in TIOPA 2010, Part 4, Chapter 1 takes priority and overrides the market value rule. The government is aware that this can allow companies to manipulate the value of such assets when making intra-group transfers. The overall impact of the targeted anti-avoidance measure announced today is that the value of the transfer will be *no less* than the market value of the trading stock or IFA transferred. Consequently, the pricing should reflect that which would be achieved on a sale to an unconnected third party. These measures have effect for transfers made on or after 8 July 2015.

GAAR penalties

The government will consult further on introducing a general anti-abuse rule (GAAR) penalty and new measures to strengthen the GAAR. A previous consultation on introducing a penalty where arrangements are counteracted under the GAAR was published in January 2015. The measures would be included in Finance Bill 2016.

The banking industry

A number of measures effecting the banking industry were announced today, which are set out below.

Corporation tax surcharge

Banks and building societies are chargeable to corporation tax on their taxable total profits in the same way as other companies. The Chancellor announced that an additional charge will be levied at a rate of 8% on the taxable profits of banking companies and building societies. The surcharge will be levied on profits arising in accounting periods beginning on or after 1 January 2016. In order to calculate the surcharge, certain reliefs will be added back to TTP. This includes any group relief for the period from non-banking companies and any relief (including brought forward losses) arising in accounting periods which end on or before 1 January 2016, or accounting periods straddling 1 January 2016, which will be notionally split. This means that relief arising in the notional period ending 31 December 2015 will be added back. Double taxation relief will be allowed in a similar way as for corporation tax.

A targeted anti-avoidance rule will also be introduced to prevent banks from entering into arrangements which try to avoid or reduce the surcharge.

The tax will not apply to the first £25 million of profit within a group, and a nominated company within the group will need to supply HMRC with details of how the £25 million allowance will be used for the period. If a banking company is not part of a group, such a statement is not required. Any unused allowance cannot be carried forward for use in subsequent accounting periods.

The surcharge will be due for payment alongside the company’s corporation tax liability. Where a company pays its corporation tax in instalments, the surcharge element of an instalment arising prior to 1 January 2016 will be treated as due at the first instalment payment date after 1 January 2016. This means that late payment interest will not arise on this element of the surcharge.

Banking companies will need to ensure that they take account of the surcharge when estimating and reviewing their quarterly instalment payments going forwards.

If a bank has an overseas subsidiary with profits that are chargeable under the CFCs legislation (TIOPA 2010, Part 9A), it will also be liable to a supplementary CFC charge. The rate of the supplementary CFC charge is equivalent to the total of the UK main rate plus the rate for the surcharge.

Changes to bank levy

The Chancellor announced that the bank levy will be reformed and the rate reduced over the next six years. Although only increased to its current rate at Budget 2015, the main rate of the bank levy will fall from 0.21% to 0.18% in 2016. It will then drop to 0.17% in 2017, 0.16% in 2018, 0.15% in 2019, 0.14% in 2020 and 0.10% in 2021. Proportionate and corresponding annual reductions will also be made to the half rate.

Although the bank levy is currently calculated by reference to a bank's worldwide balance sheet, the government has announced that from 1 January 2021 it will be restricted to apply to UK operations only. The Chancellor hopes that revising the bank levy in this way will be enough to see major global banks (such as HSBC) decide to remain in the UK.

Compensation payments

As announced at Budget 2015, and following consultation on the proposal by HM Treasury, Finance (No 2) Bill 2015 will include provisions to ensure that compensation expenses arising in relation to a bank's misconduct, management failures or mis-selling of products (such as payment protection insurance) will not be allowable as a deduction in calculating the bank's profits for corporation tax purposes. The measures have immediate effect and so will apply to expenses incurred on or after 8 July 2015.

Banking definitions

Finance (No 2) Bill 2015 will include provisions that change how 'banking companies' are defined for the purposes of the bank levy (and bank loss-relief restriction legislation, announced at Autumn Statement 2014, included in Finance Act 2015, and having effect for accounting periods beginning on or after 1 April 2015).

The definition of a banking company will be aligned with regulatory standards but should not materially impact the operation of the bank levy (or the bank loss-relief restriction).

Restriction of CT relief for business goodwill amortisation

Goodwill is defined as the balancing figure between the price paid for a business and the net value of the assets acquired. Purchased goodwill can only be recognised on a trade and assets acquisition and not on the acquisition of shares. UK corporation tax rules in CTA 2009, Part 8, Ch 3 currently allow relief against trading profits when this goodwill is amortised in the accounts, or where an election to write the goodwill down at a fixed rate of 4% is made. The rules in CTA 2009, Part 8, Ch 4 also allow for additional relief for debits arising on the disposal of the goodwill.

The Chancellor announced that relief for annual amortisation costs on assets linked to business' reputation and customer relationships (ie purchased goodwill acquisitions of customer related intangible assets), will be withdrawn. The rationale for this change is that it brings the UK corporation tax regime in line with other major economies.

Legislation will be introduced in Finance (No 2) Bill 2015 amending the current rules in CTA 2009, Part 8, withdrawing relief for all goodwill and customer related intangible asset acquisitions. The restriction on relief for amortisation will only apply to purchased goodwill and customer related intangible assets acquired on or after 8 July 2015, unless there was an unconditional obligation to enter into the acquisition before this date. Furthermore, any debits arising on disposals of goodwill and customer related intangible assets which are made on or after 8 July 2015, will be treated as non-trading debits thus restricting how they can be relieved (ie they cannot be included in the calculation of trading losses). Note however that no restriction will be made where a credit (profit) arises on such a disposal.

R&D — universities and charities

The 'Above the Line' (ATL) R&D credit was introduced for qualifying expenditure incurred on or after 1 April 2013. It allows R&D relief to be accounted for in the profit and loss account as a reduction in R&D expenditure, with the associated tax credit being offset against the company's corporation tax liability. The ATL R&D credit will entirely replace the previous super-deduction scheme available for large companies from 1 April 2016.

The ATL regime was designed for business R&D activities, rather than being available to universities or charities either for their own independent research, or for R&D they carry out as sub-contractors. However, HMRC has received a number of claims for relief from such institutions and changes have been announced to clarify the position. Universities and charities will be unable to claim the ATL R&D credit in relation to any expenditure incurred on or after 1 August 2015. This change will not affect claims made to date, and universities can continue to claim for any qualifying expenditure incurred prior to 1 August 2015. Any such institutions looking to make a claim for the ATL R&D credit would therefore be advised to incur as much of their qualifying expenditure as possible within this short window of opportunity.

Legislation will be introduced in Finance (No 2) Bill 2015, amending the qualifying conditions for relief in CTA 2009, s 104A.

Modernisation of taxation of corporate debt

The government has confirmed that Finance (No 2) Bill 2015 will include the measures previously announced at Autumn Statement 2014, but omitted from Finance Bill 2015, to update and simplify the regimes for the taxation of loan relationships (in Parts 5 and 6 of CTA 2009) and derivative contracts (in Part 7 of CTA 2009).

The changes include:

- •with effect for accounting periods commencing on or after 1 January 2016, clarifying the relationship between tax and accounting — measures will include: removing the 'fairly represent' requirement, basing the calculation of taxable loan relationship profits solely on accounting entries in a company's income statement (and so not in reserves or equity)

- •with effect from the date Finance (No 2) Bill 2015 receives Royal Assent (although originally intended to apply from 1 April 2015), the addition of a new regime-wide anti-avoidance, 'main purpose', rule applicable to loan relationships and derivative contracts, and

- •also from the date of Royal Assent of Finance (No 2) Bill 2015 (although it was originally intended to apply from 1 January 2015), a new 'corporate rescue' rule providing tax relief where loans are released in cases of debtor companies in financial distress with a view to ensuring continued solvency

With the exception of the changes to the operative dates, the proposals appear to be the same as those announced in the Autumn Statement. The government has, however, also announced that updates to the rules on the tax treatment of forex hedging, convertible instruments and property based derivatives will be introduced by secondary legislation during the course of 2015.

Consortium relief

As announced at Autumn Statement 2014, the government today confirmed that legislation will be included in Finance (No 2) Bill 2015 to remove from the consortium relief rules the requirements relating to the territory in which the 'link company' should be located.

This measure will be effective for claims to consortium relief for accounting periods beginning on or after 10 December 2014.

Orchestra tax relief

As announced at Budget 2015, tax relief will be available to orchestras at a rate of 25% on qualifying expenditure from 1 April 2016. It was confirmed today that legislation introducing the relief will be included in Finance Bill 2016.

Enquiry closure rules

As announced at Autumn Statement 2014, the government is considering the introduction of new powers to enable HMRC to close areas of an enquiry whilst leaving other areas open. A consultation document was published on 18 December 2014 providing more details on the proposals, and the closing date for comments was 12 March 2015 with government response in the summer.

Employment allowance

The employment allowance is the flat-rate reduction in the amount that most employers have to pay in secondary Class 1 national insurance contributions in respect of their employees first introduced in 2014/15.

The Chancellor announced that as from April 2016, it will no longer be available to one-man companies whose only employee is the director. There is no change in respect of the current year .

The more welcome news is that, as mentioned above, the annual employment allowance will increase from £2,000 to £3,000 as from 6 April 2016.

New apprenticeships levy for large businesses

A new apprenticeships levy is to be imposed to fund the Government's continued drive to see more apprenticeships — the Chancellor set a target of 3 million new apprenticeships by 2020. Disappointingly, there is no information available on Budget Day to explain the how the new levy will work, when it will start, who will administer it or who will have to pay it. These details are unlikely to appear before the Spending Review in the autumn.

The Chancellor suggested that the levy would only apply to "large" employers but in other regards it seems likely to be based on the model used in other European countries which involves a small levy on payroll, with the money raised being used, possibly with a top-up from Government, to subsidise those employers who decide to offer apprenticeships.

Reform of IR35

HMRC has been tasked with "improv[ing] the effectiveness" of the rules on personal service companies in a way which "protects the Exchequer and improves fairness in the system" by talking to business.

There appears to be no time scale in the Budget documentation for the expected outcome and it may be that this is achieved by an informal consultation process.

Annual investment allowance

The annual investment allowance (AIA) had been due to drop from £500,000 per annum to £25,000 per annum from 1 January 2016. The Chancellor stated at Budget 2015 that this would be addressed in the Autumn Statement, but he decided to bring the announcement forward to the Summer Budget 2015.

The AIA will be £200,000 per annum for qualifying investment in plant and machinery on or after 1 January 2016 and the Government has committed to maintaining the AIA at this level for the rest of this Parliament.

Averaging of profits for farmers

As announced in Budget 2015, it is intended that the averaging period for farmers will be extended from two years to five years from April 2016.

The consultation published on the same day as the Summer Budget 2015, shows the calculations can be quite complicated in some situations, although it is proposed that marginal relief be dropped to avoid adding more complexity which HMRC feels is undesirable.

VAT and other indirect taxes

VAT

Services used and enjoyed in the UK

The government stated that it will apply VAT 'use and enjoyment' provisions from next year in order to ensure that all UK repairs made under UK insurance contracts will be liable to VAT in the UK. The government will also consider implementing a wider review of offshore based avoidance in VAT exempt business sectors, with a view to introducing additional use and enjoyment provisions for services such as advertising in the following year. These changes will be introduced in order to combat perceived VAT avoidance schemes, such as the scheme used by Ocean Finance to avoid payment of VAT on advertising services.

Refunds for shared services

As stated in Budget 2015, the government intends to introduce legislation that will enable eligible public bodies to reclaim VAT under the VATA 1994, s33 VAT refund scheme for certain shared expenses from 1 April 2015.

VAT lock

The government announced a measure that will introduce legislation to provide that the standard rate of VAT shall not exceed 20% and the reduced rate shall not exceed 5%, and to provide that the relevant provisions will be locked to prevent them being used to remove any items from the current VAT reduced rates and VAT zero rates. These measures will be limited for the duration of this Parliament.

Alcohol duties

Tackling illicit alcohol

The government announced that it intends to create a new national alcohol control room and introduce a mobile taskforce in order to tackle alcohol fraud.

Small cider

The government announced that it is discussing with the EU Commission and other EU countries the possibility of reforming the relevant alcohol Directive so that it includes explicit references to give EU countries the flexibility to support small cider makers through the duty regime. In parallel, the government is also looking at alternatives that could apply. The government will work with industry on both of these initiatives. The government intends to retain the current duty exemption for small cider producers until a replacement scheme can be established.

Insurance Premium Tax (IPT)

Standard rate of IPT to increase

With effect from 1 November 2015, the standard rate of IPT will be increased from 6% to 9.5%. All premiums received by insurers using the IPT cash accounting scheme from this date will be levied at 9.5%. For insurers using the special accounting scheme, there will be a 4 month concessionary period beginning on 1 November 2015 and ending on 29 February 2016, during which premiums received that relate to policies entered into before 1 November 2015 will continue to be liable to IPT at 6%.

From 1 March 2016 all premiums received by insurers will be taxed at the new rate of 9.5%, regardless of when the policy was entered into.

As IPT cannot be recovered this will represent a significant increased cost for businesses and consumers who are required to pay this tax on relevant insurance premiums.

Insurance premium transparency

The government announced that the Financial Conduct Authority (FCA) has been asked to review what more can be done to encourage people to shop around for their insurance.

Tobacco duties

Tobacco levy

The government announced that it will not proceed with a tobacco levy as the impact on the tobacco market would be the same as a duty rise but the levy will create added complexity, costs and delay.

Tackling illicit tobacco abroad

Following on from the announcements made in Budget 2015, the government announced that it intends to expand its Fiscal Crime Liaison Officer network and the supporting UK intelligence staff in order to reduce the supply of illicit tobacco from Europe. It also intends to enhance the country's overseas footprint and further develop international collaboration and partnerships.

Tackling illicit tobacco

Following on from the announcements made in Budget 2015, the government stated that they will expand the number of criminal investigation teams in HMRC working on tobacco fraud by 50% and recruit additional Crown Prosecution Service staff to manage additional prosecutions.

Control of raw tobacco

The government had announced in Budget 2015 that it intends to introduce a registration scheme for users and dealers in raw tobacco and has stated that it will launch a technical consultation on the design and scope of the scheme.

Betting and gaming

Horserace Betting Right

Following on from the announcement made in Budget 2015, the government stated that it remains committed to replacing the current levy system to create a level playing field for British based and offshore gambling operators. Currently the government is undertaking a detailed design of a Horserace Betting Right and this is expected to be completed later this year.

Transport taxes

Reform of vehicle excise duty (VED) rates and bands for post-2017 cars

The government announced that a new VED banding system for cars registered on or after 1 April 2017 will be introduced. First year rates will vary according to the carbon dioxide emissions of the vehicle. There will be a flat standard rate of £140 for all cars except those emitting 0 grams of carbon dioxide per kilometre (gCO_2/km), for which the standard rate will be £0. Cars with a list price above £40,000 will attract a supplement of £310 per year for the first 5 years in which the standard rate is paid. The new VED system will be reviewed as necessary to ensure that it continues to incentivise the cleanest cars.

Creating a roads fund

The government announced that with effect from 2020/21 they will spend all of the revenue raised from VED in England on the English Strategic Road Network.

Air Passenger Duty (APD) devolution

The government published a discussion paper on options for supporting English regional airports with the impacts of APD devolution. The purpose of the consultation is to address concerns that English airports may not be able to compete effectively with Scottish and Welsh airports if they can tax their flights on a more favourable basis under their devolved powers.

Fuel duty for aqua-methanol

The government will introduce legislation in Finance Bill 2016 that will enable a reduced rate of fuel duty to apply to aqua-methanol.

Energy and environmental taxes

Climate Change Levy

The government announced the removal of the Climate Change Levy exemption for renewably sourced electricity with effect from 1 August 2015. From 1 August 2015, there will be a transitional period that will enable suppliers to claim the CCL exemption on any renewable electricity that was generated before that date providing they hold sufficient renewable levy exemption certificates (LECs) that relate to that electricity and these are used against supplies made to eligible consumers.

The government will discuss the details of how the transitional period will work with stakeholders over the summer and autumn in order to determine an appropriate time period. The legislation is being removed because the government considers that the exemption was being used to support electricity generated overseas and that renewable energy is being adequately supported under wider environmental policies. The removal of the exemption will result in increased costs for businesses buying electricity from overseas but it should simplify operating the levy for generators. Legislation will be introduced in Summer Finance Bill 2015 to amend Finance Act 2000, Sch 6, para 19.

Aggregates Levy

The government will be reinstating the Aggregates Levy exemptions that were recently found lawful by the European Commission. With effect from 1 August, businesses will no longer be required to pay tax on the exempted materials and can reclaim tax paid on materials since the exemptions were suspended in April 2014.

Environmental taxes

The government has announced that it intends to continue using the tax system to encourage positive environmental outcomes where tax is an effective instrument to do so, for example in reforming VED and the business energy tax landscape. The government however will not be extending the Coalition government's commitment to increasing the proportion of revenue from environmental taxes during this Parliament as they believe that this type of target does not necessarily reflect the government's policy in achieving successful environmental outcomes.

Business energy tax reform

The government announced that it will be reviewing the business energy efficiency tax landscape and it will be considering approaches intended to simplify and improve the effectiveness of the regime. The review will consider the Climate Change Levy (CCL), Carbon Reduction Commitment energy efficiency scheme and their interaction with other business energy efficiency policies and regulations. A consultation is to be launched in the autumn.

Tax administration

Direct recovery of debts

This proposal, which has proved very controversial amongst advisers, is to become effective "on or after" the date of Royal Asset to Finance (No 2) Bill 2015. The rules will include the safeguards offered by HMRC in November 2014 as a result of the responses to the consultation, including the need for a face to face meeting between HMRC and the taxpayer.

High risk promoters

Further to the changes to the 'promoters of tax avoidance schemes' rules in FA 2015, sch 19, there are to be amendments introduced by Finance Bill 2016 to widen the regime to include "promoters whose schemes are regularly defeated".

Simplification

The Chancellor announced that the Office of Tax Simplification is to be made permanent and its remit extended.

Following on from a previous recommendation made by the OTS, the legislation for the previously announced exemption for trivial benefits, deferred from Finance Act 2015 will be included in Finance Bill 2016.

New consultations

As usual, Budget Day has also seen the publication of a number of new consultation documents. The key ones of interest to employers are:

- Employment Intermediaries and Tax Relief for Travel and Subsistece: This was first announced in the March Budget and looks at how tax relief for travel and subsistence expenses of workers engaged through umbrella companies, personal service companies etc might be brought into line with the rules for direct employees,

- Draft legislation: review of employee benefits and expenses: This contains draft regulations to provide the statutory framework for voluntary payrolling of benefits in kind (other than accommodation, beneficial loans and credit tokens and vouchers). This part of a package delivering on recommendation made by the OTS

In addition the Chancellor announced that a discussion document will shortly be published on how to improve the administration of IR35, the legislation that applies where a worker supplies his services to a client via a personal service company.

Further consultations on anti-avoidance

The Chancellor also announced that, following consultation in January 2015, it intends to introduce tougher penalties for those who persistently enter into tax avoidance schemes that fail and to allow HMRC to publish the names of such avoiders. It also intends to apply sanctions to avoiders who repeatedly abuse reliefs as well as introducing a new specific penalty applicable to the tax advantages countered by the general Anti-Abuse Rule. In today's Budget, the Chancellor confirmed that there will be further consultation on the technical details of both these measures. It will also broaden the scope of the Promoters of Tax Avoidance Schemes regime so that it covers promoters whose schemes are regularly defeated by HMRC. Following the consultation, the intention is that t the legislation would be included in Finance Bill 2016.

HMRC compliance activity

HMRC is to receive £800m over the course of this Parliament to invest in tackling non-compliance and tax evasion, with criminal prosecutions set to triple to 100 per year.

HMRC is also set to receive "new powers to tackle those businesses who persistently engage in aggressive tax planning", which may refer to the serial avoiders, GAAR and high risk promoter changes discussed below. It is also expected that HMRC's data-gathering powers in relation to online intermediaries and electronic payment providers will be extended.

Extra resources will be made available to target non-compliance by:

- wealthy individuals
- trusts
- pension schemes
- non-domiciliaries

Also, the Government is to consult on requirements to increase the amount of information which must be reported by "wealthy individuals and trustees".

Other announcements

The following more general announcements were made in Summer Budget 2015.

Criminal investigations

The government intends to increase funding to HMRC by over £60 million by 2020/21 in order to enable HMRC to increase criminal investigations into serious and complex tax crime particularly focusing on wealthy individuals and corporates, with the aim of raising £600 million by the end of this Parliament.

Local compliance

The government will be investing approximately £300 million over 5 years from 2016 to tackle non-compliance by small and mid-sized businesses, public bodies and affluent individuals. This measure aims to collect additional tax receipts of over £2 billion by 2020/21

Simplification of HMRC debtor and creditor interest rate

The government will set the rate of interest which is applicable to taxation-related debts payable under a court judgment or order by HMRC to a rate equal to the Bank of England base rate plus 2%. The government will also apply the late payment interest rate of 3% to taxation-related debts owed to HMRC under a court judgment or order. These changes will apply to new and pre-existing judgments and orders in respect of interest accruing on and after 8 July 2015.

Making tax easier

The government stated that it will be publishing a roadmap by the end of the year that provides details regarding how it will transform tax administration for individuals and small businesses over this Parliament. HMRC will begin discussing the policy choices underpinning this roadmap with key stakeholders and delivery partners including small businesses and customer representatives over the summer

Tackling the hidden economy

HMRC's powers will be extended to acquire data from online intermediaries and electronic payment providers to find those operating in the hidden economy. The government will introduce legislation in Finance Bill 2016 following a consultation on the detail. The government will invest in new HMRC investigators from 2016 to exploit this data. The government will also create a digital disclosure channel which makes it simple for taxpayers to disclose unpaid tax liabilities

Intermediaries writing to customers in advance of receipt of data under Common Reporting Standard

The government will introduce legislation that will require financial intermediaries, including tax advisers, to notify their customers about the Common Reporting Standard, the penalties for evasion and the opportunities to disclose

Regulation of claims management companies

The government announced a fundamental review of the regulation of claims management companies (CMCs). The outcome of the review will be reported to HM Treasury and the Ministry of Justice in early 2016. Summer Budget also announced that the government will bring forward proposals for the introduction of a cap on the charges CMCs can apply to their customers. The government will consult on this and how it could work in practice.

Personal Tax

Board and lodging provided for carers (Lecture P903 – 3.22 minutes)

In addition to the special benefit and expenses legislation, which has been introduced for ministers of religion, S14 FA 2015 inserts a new S306A ITEPA 2003 exemption covering the board and lodging expenses of employed home care workers.

A home care worker is an individual employed wholly or mainly to provide personal care to another individual (I) at I's home where I is unable to care for himself or herself because of:

- old age;
- mental or physical disability;
- past or present dependence on alcohol or drugs;
- past or present illness; or
- past or present mental disorder.

S306A ITEPA 2003 states that no liability to income tax arises for 2016/17 onwards where board and/or lodging is provided on a reasonable scale for the home care worker at the home of the person who is being looked after. NIC charges are also exempted in these circumstances.

The purpose of this measure is to ensure that the person who is in need of care is not involved in additional employer-related administration or costs which might otherwise arise following the abolition of the £8,500 threshold.

Article by Robert Jamieson

Lump sums paid to armed forces personnel (Lecture P904 – 3.56 minutes)

Under the Early Departure Payments 2005 scheme, individuals leaving the armed forces before the age of 55 who are at least 40 years of age and have at least 18 years of service are entitled to a lump sum and monthly payments until they reach their 65th birthday, after which their normal pension rights mature.

An existing exemption in S640A ITEPA 2003 enables lump sum payments under the arrangements described in (a) above to be made without deduction of income tax and there is a corresponding disregard for NICs. The monthly amounts received under this scheme, however, are treated in the same way as regular pension payments and are subject to PAYE.

The Ministry of Defence introduced the Early Departure Payments 2015 scheme on 1 April 2015 (see SI 2014/2328) and the change in S15 FA 2015 extends the income tax exemption to lump sum payments under this latest scheme with immediate effect. Note that there is now a requirement for a minimum period of service of 20 years.

Article by Robert Jamieson

Settlement agreement for services was income

Summary - The UT found that a payment received on the change of management of a hedge fund was a payment for services taxable as income.

In 1999, the taxpayer set up a hedge fund, OEF. A company was needed to sponsor the fund and it was agreed that it would operate under the umbrella of Tilney Investment Management. The taxpayer joined Tilney as employee.

In 2001, Tilney left the hedge fund market, so the taxpayer made a new arrangement with a Luxembourg bank, Dexia, to sponsor the fund. As a result, the taxpayer became an employee of Dexia. As part of the employment contract, Dexia agreed to pay the taxpayer an investment bonus. However, in November 2001, the bank made him redundant. He received a redundancy payment but not the bonus.

The taxpayer started legal action against the bank relating to the non-payment of the bonus. In an out-of-court settlement the bank agreed to award him £310,000 compensation for the non-payment of the bonus.

In his 2002/03 tax return, he treated the compensation payment as a capital receipt. After an enquiry, the Revenue issued a closure notice treating the sum as chargeable to income tax under TA 1988, s 18 (Schedule D case VI).

It was common ground that the correct tax treatment of the settlement sum was the same as that of the bonus had it been paid by Dexia to the taxpayer under the terms of the contract.

The First-tier Tribunal dismissed the taxpayer's appeal, so he appealed to the Upper Tribunal.

Decision:

Mrs Justice Rose said the bonus was remuneration for services provided to the bank by the taxpayer; those services fell within case VI. It had been important for the bank to obtain the taxpayer's commitment to the transfer before the formal employment relationship began. In facilitating the transfer he would have to ensure that “staff and investors stayed on board and that … a drift of money and talent did not occur in that interim period”. There was no difficulty in describing the service provided by the taxpayer as the equivalent of other services listed in the other cases in Schedule D.

The taxpayer's appeal was dismissed.

Comments - The UT found that the payment was not for a mere introduction of Dexia, but was made under a contract to provide 'some kind of service'. The case highlights the thin line between a passive introduction and an active involvement in a venture.

Philip Manduca v CRC, Upper Tribunal

A settlement under a compromise agreement was not employment earnings

Summary - The FTT found that a settlement under a compromise agreement relating to a discrimination claim was not taxable as earnings from employment.

Mr A had worked as a trader for a bank. The issue was the treatment of a £600,000 payment he had received when leaving. He contended that the payment was not employment income, as it was compensation in relation to a threatened race discrimination claim for his unfair treatment in receiving low or no bonuses over several years and no salary increases. HMRC argued that the payment was chargeable as earnings from employment because it was designed to make good shortfalls in salary and bonus (ITEPA 2003 s 62).

Decision:

Referring to *Hochstrasser v Mayes* (1959) 38 TC 673, the FTT noted that the test was whether a payment was a reward for services past, present or future. The FTT observed that a settlement under a compromise agreement should be treated in the same way as an award by an employment tribunal. The key question was 'Why did the employee receive the payment?' Where damages were calculated by reference to underpaid earnings, while the discrimination may have manifested itself through the way in which the employee was remunerated, the damages arose not because the employee was underpaid but because the underpayment was discriminatory.

In order to succeed, Mr A therefore had to establish that the payment was made by the employer in order (rightly or wrongly) to settle a discrimination claim; and not to pay back money which it thought the appellant was entitled to under his service agreement. However, he did not have to prove actual discrimination.

The FTT considered what the parties had said about the purpose of the payment, how they had acted and their communications with each other. It concluded that the bank had not wished to defend a discrimination claim in court and that the payment had been made to settle the claim. The FTT rejected the bank's contention that part of the payment represented an additional 2005 bonus, as the payment had only been made after the race discrimination questionnaire had been served by Mr A's solicitor.

Comments - Rather than focusing on what the payment represented, i.e. underpayments of salary and bonuses, the FTT focused on the reason for the payment by the bank. Once it was established that the payment was made to fend off a discrimination claim, the payment could not represent employment earnings.

Mr A v HMRC [2015] UKFTT 189

Was a payment made because of an employee's disability?

Summary - The FTT found that a payment on termination of employment had not been made because of the employee's disability. Therefore, ITEPA 2003 s 406 was not in play and the payment was subject to tax.

Dr Flutter had sold his shares in NCG to PTC; and his employment contract with PTC had subsequently been terminated. The dispute concerned the tax treatment of a payment that Dr Flutter had received on the termination of his employment and the availability of deductions in computing the gain on the sale of his shares, as well as a penalty for negligence. It was accepted that Dr Flutter's hearing loss constituted a liability for ITEPA 2003 s 406 purposes. The issue was whether the amounts were paid 'on account' of that disability.

Decision:

The FTT noted that the cause for termination and whether there was a redundancy were not the tests that needed to be applied. The relevant test was the subjective motive for the payment by the person making it. The amounts paid by PTC under the compromise agreement were the amounts that the company would pay both as statutory redundancy and under its normal severance arrangements. Similarly, the bonus amounts were derived from the company's incentive plan and performance. The payments had therefore not been made because of Dr Flutter's disability. As for CGT, Dr Flutter had incurred expenditure in relation to the business; however, he had sold shares and the consideration had been paid for shares only, and not in exchange of Dr Flutter transferring assets to NCG. This expenditure could therefore not be added to the acquisition cost of the shares.

Finally, the FTT found that Dr Flutter had negligently delivered an incorrect return by failing to take an earlier rollover relief claim into account, which had reduced the acquisition cost of the shares. It was highly improbable that Dr Flutter had not been informed that the effect of a rollover claim would be to reduce the acquisition cost of the shares. Furthermore, he should have sought professional advice when submitting his return or at least read HMRC's guidance.

Comments - The case confirms that when assessing the tax treatment of a termination payment, the main criterion is not the reason for the termination but rather the reason for the payment.

Dr AG Flutter v HMRC TC4443

Capital Taxes

Equitable mistake

Summary – The Court granted relief on the grounds of equitable mistake

Two properties were placed in a trust for the benefit of the claimant, MF. Her father had loaned her the money to buy one of the houses. Under the settlement, the loan would be repaid when the first property was sold. The solicitor failed to appreciate that, as a result of rules introduced in the Finance Act 2006 (IHTA 1984, s 49(1A):

- the transfer of assets into the trust would be a lifetime chargeable transfer for inheritance tax purposes;
- to the extent that the net value exceeded the nil rate band, there would be an immediate entry charge of 20%; and
- there would be a ten-yearly charge and exit charges.

The charges would prevent MF repaying her father. When she learned about the mistake, the claimant applied for an order to set aside the settlement on the ground of equitable mistake. HMRC opposed the claim.

They noted that in its decision in *Pitt v Holt, Futter v Futter* [2013] STC 1148 the Supreme Court restricted the test for relief for equitable mistake in *Hastings-Bass v CIR (re Hastings-Bass deceased)* [1974] STC 211. The claimant argued that there was no avoidance motive in setting up the trust. Instead, the aim was to protect the properties from any claims that might be made on them by MF's former partner.

Decision:

Mrs Justice Proudman in the High Court, Chancery Division, said it was clear that MF's broad understanding had been based on the advice and documents presented to her. The tax consequences resulted in the settlement having an entirely different effect from the one she believed it to have been.

The judge said: "MF has made a distinct and serious mistake. The settlement was not created for the benefit of the beneficiaries but to protect MF. She now has a large tax liability which affects her ability to repay the loan which she took on the basis that it would be repaid. Taking the matter in the round, it would be unconscionable for the donees to profit from that mistake and insist on their rights under the settlement."

The relief would be granted and the settlement set aside on the ground of equitable mistake.

Comments – This case demonstrates that even following Pitt v Holt and Futter v Futter that the relief under the Hastings-Bass principle will still be granted. Of course this may be appealed.

M Freedman v Freedman and others, Chancery Division

CGT computation and lost deposits

Summary - The FTT found that the loss of a deposit resulting from the failure to complete a contract was not a loss on a disposal for CGT purposes.

The taxpayer exchanged contracts for two properties with a developer. The funds to complete were not available, however, so the developer rescinded both contracts and, as was their entitlement, retained the deposits paid by the taxpayer.

As part of his attempt to raise funds, the taxpayer had sold two other houses and wished to offset the loss of the two deposits against the gains on those disposals.

HMRC did not accept the claim. The taxpayer appealed. He said he had become beneficial owner of the new properties after the exchange of contracts. He disposed of the ownership when the contracts were cancelled. This led to the loss of the deposits which he claimed he should be able to set against chargeable gains for the same year arising from the same business.

Decision:

The FTT referred to the House of Lords decision in *Jerome v Kelly* [2004] STC 887 as authority for the proposition that TCGA 1992 s 28 only fixes the time of disposal in circumstances where there is a disposal. The FTT therefore concluded that the exchange of contracts and the completion of construction obligations by the sellers 'had not marked the acquisition of assets by Mr Hardy, or anybody else, because the transactions intended never took place; and, accordingly, the rescission of the contracts did not mark a disposal of assets on which either a gain or a loss could be realised'.

Comments - TCGA 1992 s 28 provides that the time of disposal is the time when a contract is made. However, this case confirms that this provision has no effect when the exchange of contracts is not followed by completion, so that no disposal actually takes place.

Anthony Hardy v HMRC TC4444

Paintings delivered

Summary – The Tribunal allowed the appeal in respect of the assets that had been gifted.

The taxpayer and his brother (who died in 2009) were joint executors of their mother's estate. A dispute arose over whether inheritance tax was due on paintings that had previously been given to the brothers by the mother and a great aunt.

The taxpayer said his mother gifted the paintings in 1985. They were removed from the family home, given to the brothers, then re-hung in the family home because neither brother, at the time, had a suitable home in which to keep them. Also in 1985, the great aunt expressed an intention to give some paintings to the brothers, although they remained in her house until she moved into a care home in 1991. They were then delivered to and kept in their parents' home on behalf of the brothers.

HMRC said because the paintings had remained with the parents, this did not technically amount to delivery.

Decision:

The First-tier Tribunal said to "effect a gift there has to be intention and … delivery". The judge accepted the taxpayer's account as "entirely credible". The brothers lived at the parental home for several years after the gift and later did not have the space or security to hold valuable assets. The judge decided that the parents held the paintings "on behalf of and to the order of their sons". On the great aunt's gift, the tribunal found that the paintings were gifted to the brothers in 1991 and delivered to the parents on their behalf.

The taxpayer's appeal was allowed.

Comments – The case demonstrates the importance of ensuring that all aspects of a transaction are completed. The judge took a pragmatic view rather than the HMRC rather theoretical view.

M Scott v HMRC TC4455

Holiday letting businesses and business property relief

Summary - The FTT held that a holiday letting business did not qualify for business property relief (BPR).

Mrs Green ran a holiday letting business. She had transferred 85% of the business to a settlement (the trust) and the issue was whether the transfer qualified for 100% BPR under IHT 1984 ss 104 and 105.

Decision:

Applying *George [2003] EWCA Civ 1763* and *Pawson* [2013] UKUT 50, the FTT found that a number of Mrs Green's activities were investment activities, including marketing, pricing, booking accommodation, dealing with complaints and requests, insurance, repairs and maintenance. The extra services provided (such as cleaning) were both relatively minor and ancillary to the provision of the accommodation. Furthermore, the FTT rejected the contention that the difference in rent between a holiday letting and an assured shorthold tenancy represented the value of the services provided under the holiday letting. The percentage of the rent attributable to those services must be small, as the price was mainly attributable to 'the location of the property, the season, to supply and demand'.

Comments - The FTT observed that 'the owning and holding of land in order to obtain an income from it is generally to be characterised as an investment activity'. Establishing that a letting business qualifies for BPR is therefore likely to be a tall order in most cases. When the Pawson case decision went against the taxpayer in the Upper Tribunal it had precedential authority and unfortunately never went to the Court of Appeal. We have here one of what are likely to be over the course of time many cases where IHT BPR will be denied on letting businesses.

Anne Christine Curtis Green v HMRC [2015] UKFTT 236

Administration

Suspected undeclared takings

Summary - The FTT accepted the taxpayer's explanation for what did look like undeclared takings.

Mr Jackson hired out limousines. During an enquiry, HMRC had noticed the low ratio of cash to card payments — £900 and £10,323 respectively. On the basis that Mr Jackson's terms required cash payments on the night, HMRC had concluded that takings had been underdeclared and had issued an assessment accordingly.

At the hearing, Mr Jackson explained that his was mainly a card payment business. Most of his work involved groups of young people who paid at the end of the evening by offering several credit cards. Furthermore, HMRC's assumption that longer journeys generated higher fees was wrong. This was because long journeys had to meet competitors' rates, even when this produced only a small profit. Finally, the drop in takings could be explained by the fact that the number of cars had dropped from three to two.

Decision:

The FTT regretted the lack of communication between Mr Jackson and HMRC, noting that Mr Jackson had only explained the discrepancy highlighted by HMRC at the hearing. The FTT also vehemently criticised Mr Jackson for his bookkeeping, which fell far short of what was acceptable. However, the FTT found that Mr Jackson was an honest witness and accepted his explanations for the takings of the business. In the absence of evidence (in particular, banking evidence) supporting HMRC's case that takings had been undeclared, the appeal must therefore be allowed.

Comments - The taxpayer did win the appeal, but the hearing might have been avoided altogether if his bookkeeping had been in order (so that HMRC could understand the records) and if he had taken the time to explain to HMRC the way his business operated.

Peter N Jackson v HMRC TC4414

Reliance on accountant and reasonable excuse

Summary - The FTT found that a taxpayer had a reasonable excuse for the late payment of CGT.

Mrs Mahendran had sold a property and the monies to pay the CGT were held by her solicitor. She had submitted an unsolicited return with a liability of £12,544 consisting entirely of CGT. Payment was due by 31 January 2014 but it was not made until the following September; and HMRC had imposed penalties under FA 2009 Sch 56.The issue was whether Mrs Mahendran had had a reasonable excuse.

Decision:

The FTT first dismissed any contentions that her illness had prevented her from managing her tax affairs, given that she had been able to perform her duties as a primary school teacher and that she had been able to instruct accountants.

Referring to *Rowland* [2006] STC (SCD) 536, the FTT found that it had been 'sensible and reasonable' for Mrs Mahendran to rely 'upon persons whom she reasonably believed to have the relevant specialist knowledge and expertise'. The issue, under FA 2009 Sch 56 para 16(1)(b), was therefore whether she had taken 'reasonable care to avoid the failure'. The FTT noted that she had diligently provided her accountants with any information requested and had chased them on several occasions. The FTT added that it had been reasonable for her not to contact HMRC to ask for assistance before the due date, as she thought that matters were being dealt with by her accountants.

Comments - This case offers a useful illustration of the way FA 2009 Sch 56 para 16(1)(b) operates. Taxpayers wishing to rely on this provision should ensure that, like Mrs Mahendran, they keep records of communications (or failed communications) with their tax agents.

Sudar Shini Mahendran v HMRC TC4470

Reasonable excuse - Notification situation

Summary – The Tribunal found that the company did have a reasonable excuse for the delay

The usual place of business of the taxpayer was an address in Essex, which was shared by its solicitors. The taxpayer's registered address was in London and this was shared by its accountants.

HMRC had sent the taxpayer nine decisions about its VAT liability and misdeclaration penalties. Decisions 2, 3 and 4 were sent to the taxpayer with an error in the address, so copies were sent on 2 October 2009 to the taxpayer's solicitors. Copies were also sent to the taxpayer's accountants on 9 November 2009.

Decision 8 was sent to the accountants on 16 March 2010.

On 21 February 2012, HMRC issued assessments relating to periods from 03/06 (including copies of decisions 2, 3, 4 and 8) to the taxpayer at the accountants' London address, together with copies of the corresponding notifications of the misdeclaration penalties.

A day later, the taxpayer lodged an appeal with the First-tier Tribunal asking to bring late appeals against the nine decisions. The tribunal refused permission to appeal out of time in eight cases, but gave permission in decision 9.

The taxpayer appealed to the Upper Tribunal in relation to six decisions (2, 3, 4, 5, 6 and 8). The Revenue cross-appealed on decision 9. There was no appeal for decisions 1 and 7.

Decision:

The Upper Tribunal said the issue for decisions 2, 3, 4 and 8 centred on when the assessments had been notified to the taxpayer. The fact that the solicitors were acting for the taxpayer did not necessarily give them the authority to receive the assessments on behalf of the company.

The point, though, was whether there was evidence to show that they had been given that authority. The judge decided that there was not. The letter of authority between the client and its solicitors was limited to dealing with payment of VAT, not receiving assessments. Similarly, the accountants had no such authority. The First-tier Tribunal had therefore been wrong to find that decisions 2, 3, 4 and 8 had been notified to the taxpayer on 2 October 2009, 9 November 2009, and 16 March 2010. They had been notified to the taxpayer on 21 February 2012 and, as a result, the appeal made on 22 February 2012 was in time, and no permission for a late appeal was required.

Likewise, the appeals in respect of decisions 5 and 6 could also proceed.

On decision 9, this was received by the taxpayer on 17 October 2011, but it failed to appeal until 22 February 2012. No reason was submitted for the delay and it would not be in the interests of justice to permit the appeal to proceed out of time.

The taxpayer's appeal in relation to decisions 2, 3, 4, 5, 6 and 8 was allowed and HMRC's appeal on decision 9 was allowed.

Comments - This case is a useful reference for any taxpayer faced with a claim by HMRC that they have been notified of an assessment sent to their advisers. It is also a reminder that taxpayers are expected to have a minimum of 'common sense', so that an obvious mistake on an assessment will not make it invalid.

Romasave (Property Services) Ltd v CRC, Upper Tribunal

No reasonable excuse - Fixed and variable penalties

Summary - The FTT found that reasonable excuse was not established and that fixed penalties should be upheld but that a variable penalty should be set aside.

CJS provided lightning protection. It had engaged Hudson, a company which claimed that it would undertake all construction industry scheme (CIS) requirements. HMRC later on contacted CJS, explaining that Hudson was 'net' for CIS purposes and that CJS should have continued to deduct and pay 20% tax. HMRC imposed penalties totalling £81,000 (including £56,500 'month 13' penalties).

Decision:

The FTT accepted that Mr Sanders, director at CJS, had held a genuine belief that the company's CIS responsibilities were taken care of. It was also reasonable to engage a firm such as Hudson.

However, it was not reasonable for Mr Sanders not to have sought advice from a lawyer to ensure that he understood the terms of the arrangement with Hudson. It was also not reasonable for him not to question the fact that, after entering the arrangement with Hudson, he was paying less tax than previously. Consequently, Mr Sanders did not have a reasonable excuse.

As for reliance on Hudson, the FTT accepted that reliance on a third party can be a reasonable excuse but this was not the case here. First, as mentioned above, Mr Sanders should have questioned the arrangement; and second, the colourful language used by Hudson in its marketing leaflets was not that of a professional firm giving independent advice.

However, a 'month 13' penalty was not a fixed penalty and so it could be reduced by the FTT (TMA 1970 s 100B(2)(b)). The FTT found the penalty excessive and reduced it to nil. In doing so, it took the following into account: Mr Sanders had behaved honestly; he had acted promptly on being contacted by HMRC; CJS had an excellent compliance record; and the 'month 13' penalty represented 50% of the company's annual profit in its 'best year ever'.

By contrast, the fixed penalties could only be changed by the FTT if they were 'incorrect'; for example, if the numbers had been wrongly calculated or if the company had not in fact failed to submit a CIS return (*Bosher* [2013] UKUT 579). The penalties were correct.

Comments - This case provides a useful example of the way the FTT will approach reasonable excuse — in particular, genuine and reasonable belief and reliance on a third party — as well as fixed and variable penalties.

CJS Eastern v HMRC [2015] UKFTT 213

Partnership payment notices: application for interim relief

Summary - The High Court granted interim relief in relation to partner payment notices (PPNs), but only in the limited terms accepted by HMRC.

This was an application for interim relief in the context of an application for judicial review which had been brought by the claimants challenging PPNs issued by HMRC. A PPN is an APN (accelerated payment notice) issued to a partnership under FA 2014 Sch 32. The PPN regime confers no statutory right of appeal to a specialist tribunal and the only way to challenge a PPN is to apply for a judicial review — or to rely on the invalidity of the PPN as a defence to any subsequent enforcement decisions.

Decision:

The High Court expressed doubt as to whether it did have jurisdiction to grant an injunction on the facts of the case, given the mandatory and unambiguous language of the legislation. In any event, relying on *CC & C* [2014] EWCA Civ 1653, it would not exercise such power as there was no reason for it to interfere with the statutory scheme.

The scheme presupposed that HMRC would comply with its statutory duties. Any questions as to whether there was an excuse for the non-payment of penalties should be dealt with by the FTT, if and when HMRC had made a decision on it.

The High Court therefore only granted limited relief in the form of an order that, in the event that the claimants had established hardship, HMRC could not, without first applying to the court, take steps to enforce any sum due and payable under any PPN.

Comments - The case follows a similar line to that adopted by the High Court in *Nigel Rowe and others v HMRC* (unreported). Unless a taxpayer can establish hardship, he will have to pay the tax demanded under an APN.

R (on the application of Dunne) v HMRC [2015] EWHC 1204

Late appeals in the tribunals

Summary - The FTT found that the taxpayer should not be granted permission to make a late appeal.

The issue was whether Citipost should be allowed to make a late appeal against post-clearance demand notes (PCDNs) issued by HMRC.

Decision:

The first question was the approach the FTT should follow. Should it adopt the 'three stage approach' set out in *Denton v White* [2014] EWCA Civ 906, where 'all the circumstances' are not considered until the third stage; or follow *Data Select v HMRC* [2012] UKUT 187, which has no three-stage approach but only requires that all the circumstances be considered and balanced. In *Leeds City Council v HMRC* [2014] UKUT 350, the UT had held that the correct approach was that of *Data Select*; whereas in *McCarthy & Stone (Developments) Ltd* [2014] UKUT 196, the UT had found that the *Denton* approach should be followed.

Choosing to follow *Leeds*, the FTT noted that when the Court of Appeal had found in *Denton* that a three-stage test must be used, it had been giving guidance about the operation of the CPR, which, inter alia, emphasise the saving of costs. The tribunal rules do not have such an emphasis. The FTT would therefore give equal weight to all factors.

In this particular case, the FTT noted the very significant length of the delay, the lack of any good reason for not appealing within the time limit, and the need to ensure fairness as between taxpayers. The factors outweighed the only factor for permission, that of risking the payment of money which may not be due.

Comments - Faced with contradictory case law of equal standing, the FTT had to choose. It remains to be seen whether a differently constituted FTT will come to the same conclusion.

Citipost Mail v HMRC [2015] UKFTT 252

Office of Tax Simplification (OTS) sets out principles for avoiding complexity

The OTS has published a report on avoiding tax complexity which sets out lessons it has learnt and four principles for politicians and policymakers. The report notes the difficulties caused by complexity, why the tax system tends to become complex and the different kinds of complication that can arise.

The four principles put forward by the OTS are:

- Make sure that the policy aim is best met by the proposed tax measure, or whether it might be met in another simpler way
- Make sure the measure is properly focused, resisting pleas by special interest groups and not including unnecessary anti-avoidance
- Design the measure to meet the aim carefully, making use of existing concepts and rules where possible
- Keep rules up to date and get rid of them when no longer needed

The OTS has also finalised its complexity index, a spreadsheet tool for analysing and measuring the relative complexity of the UK tax system. It will be used to identify future projects and to monitor changes in complexity in different areas of tax

Taxpayer Charter – Background and use in HMRC enquiries (Lecture P905 – 13.10 minutes)

Background

'Your Charter' is published by HM Revenue & Customs (HMRC). HMRC explains: "We want to give you a service that is even-handed, accurate and based on mutual trust and respect. We also want to make it as easy as we can for you to get things right." HMRC also points out: "This Charter explains what you can expect from us and what we expect from you."

The Charter has a basis in statute. This has been the case since 21 July 2009, when the Commissioners for Revenue and Customs Act 2005, s 16A ('Charter of standards and values') was introduced (in FA 2009, s 92(1)).

The above legislation requires a Charter. It states: "the Charter must include standards of behaviour and values to which [HMRC] will aspire when dealing with people in the exercise of their functions." The Commissioners for HMRC must regularly review the Charter, and amend or revise the Charter where it is considered necessary (CRCA 2005, s 16A(2), (3)).

Furthermore, at least once a year the Commissioners for HMRC must make a report reviewing the extent to which HMRC have demonstrated the standards of behaviour included in the Charter (CRCA 2005, s 16A(4)).

These annual reports can be accessed via the GOV.UK website:
https://www.gov.uk/government/publications/your-charter-annual-report-summary

Your Charter can be downloaded from the GOV.UK website: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/91888/charter.pdf.

Charter rights

'Your Charter' broadly comprises nine taxpayer rights. It also contains three obligations (i.e. what HMRC expects from taxpayers); namely to be honest, respect HMRC staff and take care to get things right.

The nine taxpayer rights (i.e. what the taxpayer can expect from HMRC) are reproduced below:

"What you can expect from us:

1. Respect you
2. Help and support you to get things right
3. Treat you as honest
4. Treat you even-handedly
5. Be professional and act with integrity
6. Tackle people who deliberately break the rules and challenge those who bend the rules
7. Protect your information and respect your privacy
8. Accept that someone else can represent you
9. Do all we can to keep the cost of dealing with us as low as possible."

HMRC enquiries

The Charter applies to HMRC's interactions with taxpayers generally, and is meant to cover HMRC's standards of behaviour and values. Whilst the Charter does not relate specifically to enquiries, HMRC must adhere to the taxpayer's rights in the Charter during an enquiry.

Indeed, HMRC guidance on the Charter in its Enquiry manual instructs its officers as follows (EM0020): "You must always make customers aware of their rights and obligations at the appropriate stage of the enquiry."

Some of the rights in Your Charter are probably more relevant than others when it comes to an HMRC enquiry into an individual's tax return:

- 'Respect you' and 'Be professional and act with integrity' (Right 1)

  This right regulates the behaviour of officers in HMRC enquiries (e.g. "treat you with courtesy and consideration").

- ‘Treat you as honest’ (Right 3)

  HMRC states: “Unless we have a good reason not to, we will presume that you are telling us the truth.” Thus (for example) when HMRC open a tax return enquiry, a presumption of honesty should be the starting point (unless HMRC holds information to the contrary, in which case they would normally say so).

  In addition, HMRC state that they will “only question what you tell us if we have good reason to.” Thus a ‘fishing expedition’ (i.e. investigating a tax return without having any reason to suspect that it is wrong) does not appear to sit comfortably with the taxpayer’s right to be treated as honest.

- ‘Be professional and act with integrity’ (Right 5)

  HMRC states: ““We will…respond to your queries and resolve any problems as soon as we can.” This is arguably justification to expect the HMRC officer to deal with correspondence during an enquiry in a similar timeframe to those set for the taxpayer. In any event, HMRC should not procrastinate during the enquiry.

- ‘Do all we can to keep the cost of dealing with us as low as possible’ (Right 9)

  HMRC states: “We aim to take up as little of your time and money as we can.” Thus (for example) HMRC should not routinely request meetings. If a meeting is considered necessary, the HMRC officer should be mindful of the potential cost implications for the taxpayer (e.g. in terms of potential professional fees), before requesting one.

Complaints

Taxpayers and advisers who consider that HMRC has not applied ‘Your Charter’ appropriately during an enquiry and/or feel that they have a genuine grievance about the way in which HMRC has handled the enquiry should not be afraid to make a complaint. General guidance on making complaints can be found in HMRC’s factsheet ‘Complaints’: www.gov.uk/government/uploads/system/uploads/attachment_data/file/366068/complaints-factsheet.pdf).

Article by Mark McLaughlin

Deadline dates for July 2015

1 July 2015

- Payment of corporation tax for periods ended 30 September 2014 if not liable to pay by instalments.

5 July 2015

- Non-resident landlords' scheme forms NRLY and NRL6.
- Report non-cash benefits that are not from a registered pension scheme.

6 July 2015

- Benefits in kind. Forms P9D, P11D, P11D(b) for 2014/15 must be completed.
- Provide employees with 2014/15 benefits information.
- PAYE settlement agreements for 2014/15 must be finalised.
- Taxed award scheme returns.
- Details of redundancy packages for 2014/15 worth more than £30,000 to HMRC.
- Election to aggregate beneficial loans in 2014/15.
- File forms 42.

7 July 2015

- Due date for VAT return and payment for 31 May 2015 (electronic payment).
- File forms EMI40.

14 July 2015

- CT61s for quarter ended 30 June 2015.
- Monthly EC sales list if paper return used.

19 July 2015

- Pay PAYE/CIS for month ended 5 July 2015 if by cheque.
- Pay PAYE liability for q/e 5 July 2015 if average monthly liability is less than £1,500.
- Payment of 2014/15 class 1A NICs by cheque.

21 July 2015

- Online monthly EC sales list.
- Intrastat – June 2014 payment of supplementary declaration.

22 July 2015

- PAYE/NIC/student loan payments if being paid online.
- Pay 2014/15 class 1A NICs electronically.

31 July 2015

- Companies House should have received accounts of private companies with 31 October 2014 year end.
- Second 5% surcharge for unpaid 2013/14 balancing payments.
- 2014/15 second instalment SA liabilities are now due.
- Tax credits claims to be finalised and renewed.
- Companies House should have received accounts of plcs with 31 January 2015 year end.
- CTSA returns for accounting periods ended 31 July 2014.
- Annual adjustment for VAT partial exemption claims – April year end, if not on April return.

HMRC News

HMRC issues brief on compound interest on overpaid VAT

HMRC has issued *Revenue & Customs Brief 09/15.* This sets out its position following the Court of Appeal's recent judgment in the case of *Littlewoods Retail Ltd and others* concerning the availability of compound interest on refunds of overpaid VAT, in circumstances where the VAT was paid and collected in breach of EU law.

In its judgment handed down on 21 May 2015, the Court of Appeal found against HMRC. They held that the Littlewoods claimants were entitled to compound interest where VAT had been overpaid. HMRC confirms in the Brief that it does not agree with the judgment and that it has requested permission to appeal to the Supreme Court. In addition, HMRC maintains that the guidance provided by the judgment about the availability of compound interest is neither clear enough nor sufficiently general to be applied to other High Court claims for compound interest.

Therefore HMRC will apply for any claims for compound interest already lodged with the High Court to continue to be stayed pending the final determination of the Littlewoods litigation so that no payments will be made to other claimants at this stage.

HMRC's position in relation to Tribunal appeals on this issue remains unchanged, namely that these should continue to be stood over until there has been a final determination as to the availability of compound interest in the UK. Any new requests for compound interest will continue to be refused. Finally, HMRC confirms that it will reconsider its position in the event that permission to appeal to the Supreme Court is refused.

HMRC publishes guidance on employment allowance planning

HMRC has updated its guidance following recent media coverage of planning designed to exploit the employment allowance giving relief from employer's national insurance contributions.

The planning involves transferring staff to a payroll company that sets up numerous employment companies, each of which employs a small number of those staff. The business at which the staff used to work is invoiced for the services that they provide to it. Meanwhile, each employment company claims the full employment allowance to wipe out any employer national insurance contributions liability.

HMRC has published its view that the planning does not work on the basis that it is caught by a targeted anti-avoidance rule in the employment allowance legislation.

PAYE Late filing penalties

HMRC has now issued the first in-year penalties notices to employers with fewer than 50 employees who missed the deadline for sending PAYE information to HMRC.

Rather than issue late filing penalties automatically when a deadline is missed, HM Revenue and Customs (HMRC) will take a more proportionate approach and concentrate on the more serious defaults on a risk-assessed basis.

This approach is in line with the likely direction of HMRC's general approach to penalties, outlined in the HMRC penalties: a discussion document which it issued earlier this year and in HMRC's fresh approach to considering appeals against late filing penalties for Self Assessment.

Late reporting penalties already apply to employers with 50 or more employees, so this 'risk-based' approach will apply to submissions that were late from:

- 6 March 2015 for employers with fewer than 50 employees, and
- 6 January 2015 for employers with 50 or more employees.

HMRC will continue to issue risk-based penalties for the tax year 2015 to 2016 tax year.

HMRC does not want to charge penalties, but wants employers to report on time. It wants to help employers who are trying to do the right thing, rather than penalise them.

This move to issuing risk-based late filing penalties also continues HMRC's strategy of adapting its approach, where necessary, before moving to the next phase of implementation.

This approach will enable HMRC to concentrate more resources on the more serious failures to comply, and to focus on educating employers about their filing obligations through targeted communications, webinars and Employer Bulletin articles.

It applies in addition to HMRC's recent announcement that it will not be penalising minor delays of up to three days. HMRC will monitor both, and review by April 2016.

Even if employers do not get a penalty, they are required by law to file on time and if they do not may be charged a penalty on a future occasion. The deadlines for sending PAYE information stay the same, including the requirement to send PAYE information on or before the time that employees are actually paid or due to be paid.

Employers can appeal electronically using the Penalties and Appeals System (PAS) on HMRC Online. Employers who receive a late filing penalty notice for tax year 2014 to 2015 quarter 4 but who filed within three days of the reporting deadline may appeal and should use reason code A as set out in the What happens if you don't report payroll information on time guidance.

HMRC acts to improve customer service

HM Revenue and Customs (HMRC) announced it is allocating £45 million to improve customer service, as it released statistics which showed an inconsistent call handling performance in 2014-15.

The allocation is paying for around 3,000 additional staff to join customer service teams, on top of around 2,000 staff who are being moved over from other parts of HMRC to help with the tax credits deadline and letters and forms.

HMRC receives more than 60 million calls a year, peaking around key deadlines such as 31 January for Self Assessment, and 31 July for tax credits renewals.

The statistics show that while 73 per cent of calls were answered last year, service standards were inconsistent across the year, with some months falling well short of HMRC's 80 per cent target. The figures also show that in some months as many as one in five customers heard a busy tone and could not join a phone queue.

Lin Homer, HMRC Chief Executive, accepted that standards had not been good enough and outlined the actions that HMRC has already taken to improve customer service, including recruitment and investment in technology.

Ms Homer said:

Despite our best efforts, our call performance hasn't been up to scratch and we apologise to all those customers who have struggled to get through to us.

Good customer service is an absolute priority for HMRC. We set ourselves the target to answer 80 per cent of calls, to provide a more consistent level of service across the year and to reduce peaks and troughs in service levels between busy and quieter times.

While we were successful in tackling the busiest peaks for Self-Assessment and tax credits customers, we didn't meet our call handling target overall and we didn't provide the consistent service to which we aspired.

We have gripped this issue and recruited around 3,000 new staff in our customer operations and moved around 2,000 people from other parts of HMRC temporarily to support customer service in the run-up to the 31 July tax credits deadline.

We are already seeing the benefit of this, and we are answering 60-70 per cent of calls on tax credits helplines. Tax credits renewals overall are more than 211,000 up on the same time last year.

Ms Homer added:

We have also invested in new telephone equipment, which lets us switch calls to many more offices, not just take them in contact centres, so more of our staff can help customers at the busiest times.

Our new online services are also giving customers new and better ways to deal with HMRC and I urge all customers who can go online to do so. For services like tax credits, it's quick, simple and can be done anywhere any time, including from a smart phone.

So far this year, 265,000 tax credits customers have already renewed online, against 97,000 at the same point last year. Satisfaction rates with the online service are high, at around 80 per cent.

Note - Daily Telegraph, 26 June 2015: Between April 2014 and March 2015, 64.7m calls were made to HMRC's tax enquiry line, but more than one in ten calls went straight to a busy tone, HMRC figures show. Around 7.2m call attempts were unanswered.

Changes to HMRC Phone numbers

From 30 June 2015 all HMRC 0845 helpline telephone numbers will be taken out of service.

From 30 June 2015, we are withdrawing our 0845 helpline telephone numbers. Customers should instead use our 03 helpline telephone numbers.

This change was announced in August 2014 and since December 2014 customers calling a 0845 number that has been taken out of service have heard a message providing the new 03 number before the call is ended.

0845 helpline telephone numbers will be decommissioned from 30 June and customers dialing those numbers will hear a dead line tone.

Customers can find our 03 helpline telephone number on our contact us page.

For most customers, an 03 number is cheaper to call than an 0845 number, and it is government and Ofcom policy is to use 03 numbers.

2014-15 PAYE Tax Calculations - over and under payments

We have started the annual End of Year Reconciliation process – a normal part of the PAYE (Pay as You Earn) system – to check that people have paid the right amount of tax in 2014-15. This has been a key feature of the PAYE system since it was first introduced over 70 years ago.

We are sending P800s that show an overpayment of tax first, followed by a cheque around a fortnight later. You don't need to do anything.

The whole process should be completed in October.

This automated process ensures those who have had a change in circumstances during the last tax year (2014-15) that was not captured in their tax code have paid no more or less than they should. Any discrepancy could be because the taxpayer changed jobs, had more than one job for a time, a change of company car or received investment income that was not reported during the year.

The vast majority of PAYE taxpayers will have paid the right amount of tax for the year and will not be contacted by HMRC.

Business Taxation

B share schemes (Lecture B903 – 5.59 minutes)

The Chancellor announced in his Autumn Statement on 3 December 2014 that he intended to close down the tax planning opportunities offered by the implementation of special purpose share schemes (commonly referred to as 'B share schemes').

These arrangements are usually set up by listed companies that want to return cash to their shareholders. Although the actual structure will vary, typically a new class of share (often redeemable shares) is issued on a pro rata basis to the company's shareholders. The main point of a B share scheme is that shareholders can choose what form their 'dividend' takes. They might receive an income dividend with its associated tax credit (after which the shares will convert into a different class with limited or no rights). Alternatively, the shares may be redeemed which normally involves the shareholders suffering a CGT charge on their gain.

Accordingly, S19 FA 2015 has inserted a new S396A ITTOIA 2005, the provisions of which will apply where a person has a choice between receiving an income distribution or alternatively something else which is essentially of the same value but which is not chargeable to income tax. This latter is called 'the alternative receipt'. The test whether the alternative receipt is of 'substantially the same value' as the dividend can be applied at either the distributing company or the receiving shareholder level.

The alternative receipt is treated as an income distribution in the tax year in which it is received. This takes effect for receipts on or after 6 April 2015.

S396A(3) ITTOIA 2005 explains that it does not matter if the choice is subject to the exercise of any conditions or power and also that this choice can include the failure to exercise a right.

S396A(4) – (6) ITTOIA 2005 provides that a claim for relief can be made where, as a result of the charge on the alternative receipt, there is a double charge. For example, where a company issues bonus B shares to shareholders who so elect and the B shares carry a right of purchase by a third party, both the issue of the shares and the sale to the third party will create separate tax liabilities (the first an income tax charge under S396A ITTOIA 2005 and the second as a capital gain). In these circumstances, HMRC are obliged to make a 'just and reasonable' adjustment to eliminate the double hit.

Article by Robert Jamieson

The employment allowance and connected companies

The CIOT has recently published a warning on the Employment Allowance connected companies rules.

The CIOT understands that many groups have been inadvertently claiming multiple Employment Allowances and there is a window to correct this quickly and reduce the risk of penalties being charged in the future.

Most employers can reduce the National Insurance Contributions they pay by up to £2,000 per tax year by claiming the Employment Allowance.

However, if you are connected companies or charities only one company or charity in the group can claim the allowance. We understand that HMRC has identified a number of cases where multiple companies or charities within a group have each claimed the allowance. This seems to have arisen where the businesses or charities have claimed the allowance without first checking how the restriction on groups arise.

The CIOT understand that there is a small window of opportunity for employers to correct their mistake through RTI without a penalty being charged for the time being. HMRC can easily identify groups claiming more than one Employment Allowance and as time goes on HMRC will be taking a stricter line on imposing penalties.

The above should not be confused with avoidance cases HMRC is currently investigating, which seek to exploit the Employment Allowance through contrived schemes (see HMRC News above).

Further information on the Employment Allowance is available on Gov.UK at www.gov.uk/claim-employment-allowance and detailed guidance on connected companies and charities can be found at www.gov.uk/government/publications/employment-allowance-more-detailed-guidance.

CIOT Technical Team, 19 June 2015

Flat has a dual purpose

Summary – The Tribunal found that the flat used by Tim Healy, the actor, had a dual purpose

The taxpayer was an actor taking part in a musical in London. In his 2005/06 tax return, he claimed the cost of renting a flat near the theatre where he was performing.

HMRC refused the claim under ITTOIA 2005, s 34(1)(a). The First-tier Tribunal allowed the taxpayer's appeal on the ground he was not looking for a permanent home in the capital. The Upper Tribunal said the first tribunal had failed to apply the "wholly and exclusively" test properly and remitted the case to the First-tier Tribunal for a fresh hearing.

The taxpayer explained that, because he lived in Cheshire, he needed accommodation in London while he was in the show. He chose to rent a three-bedroom flat because it cost no more than staying in a hotel and would allow him to have family and friends to stay.

Decision:

The First-tier Tribunal said it had to "consider the appellant's intentions at the time he entered into the tenancy agreement". It was clear from his evidence that he wanted to be able to have space for visitors "and this was a consideration when deciding which particular flat to rent". The tribunal judge said, for the purposes of ITTOIA 2005, s 34(1), this was an independent purpose and therefore the cost of the flat had a dual purpose. Renting a flat allowed him to carry out his duties in London but also enabled him to have guests to stay. The latter was not a business purpose and the "wholly and exclusively" test in s 34(1) was not satisfied.

As a result of reaching this conclusion, the tribunal said it was unnecessary to consider whether the expenditure had another non-business purpose of meeting the taxpayer's ordinary needs for warmth and shelter.

On the taxpayer's contention that if there were duality of purpose, he should be allowed a proportion of the expenses (s 34(2)), the tribunal said there had to be an "identifiable part or identifiable proportion of the expense which is incurred wholly and exclusively for the purposes of the trade". The judge decided the taxpayer had not produced any evidence to show any expenditure related only to his trade.

The taxpayer's expenditure on renting the flat was therefore not allowable.

The taxpayer's appeal was dismissed.

Comments – The test of whether expenditure has been incurred wholly and exclusively for the purpose of the business has been around for a long time. The moment that the taxpayer admitted to another, dual, purpose his argument was dead in the water.

Tim Healy v HMRC TC4425

'Repos' and the loan relationship rules

Summary - The FTT found that income relating to interest coupons under a repo was a credit under the loan relationship rules.

Abbey National Treasury Services (ANTS) is a UK company which is part of the Santander Group. On 9 March 2007, ANTS and Santander entered into a sale and option deed (the 'repo'), under which ANTS sold to Santander the right to receive interest under floating rate notes (FRNs) comprising interest. It was accepted that the FRNs were loan relationships of ANTS; and that the repo was properly treated as a 'repo'. The issue in dispute was whether the amounts credited to ANTS' income statement for the 2007 accounting period relating to the interest coupons should be treated as a taxable credit under the loan relationship rules (FA 1996 ss 84(1), 85A and Sch 9).

Decision:

The FTT observed that the tax legislation accepts that in an interface between legal and accounting concepts, there could be some tension; it therefore provides a safeguard, by providing that one first looks at the result produced by the accounting analysis, and then considers whether that represents a fair representation of the profits or losses generated by the transaction. Here, the accounting starting point was that the FRN coupons were recognised by ANTS during the term of the Repo. It was therefore necessary to consider whether there was any basis on which the accounting basis could be overridden.

The FTT found that if those profits recognised in ANTS' income statement did not arise from its loan relationships, the FRNs to which it remained a party, 'it was hard to see what they arose from'. Furthermore, the accounting analysis was closely aligned to the legal and economic reality, given ANTS' continued economic exposure to the variability in the value of the interest coupons.

Comments - The FTT noted that 'the question of who should properly bear tax on the interest arising on securities which are the subject of a sale and repurchase transaction during the term of that repo is problematic for the UK tax code'. This was evidenced in the eponymous *DCC Holdings* [2010] UKSC 58. This case therefore provides a useful example of the way the legislation should be applied.

Cater Allen International and Abbey National Treasury Services v HMRC [2015] UKFTT 0232

Irrelevant argument

Summary – The Tribunal found that to obtain relief for the expenses there had to be evidence and there was not.

While the taxpayer, who retired in 2007, was travelling, his UK home was renovated. He had also used it to carry on his business as a consultant quantity surveyor. He provided some of his services through two companies which he used as umbrella companies for other surveyors to work through.

In his 2005/06 tax return, he claimed expenses against the profits of the companies. HMRC disallowed them on the ground the taxpayer had offered no evidence to substantiate them.

The taxpayer appealed. He said it was difficult to provide the documents relating to the expenses because he had been abroad during the renovations. He added that the payments had been declared and taxed in the companies' accounts and so should be deductible for him.

Decision:

The First-tier Tribunal said the taxpayer had to show the expenses were wholly and exclusively incurred for the purpose of his trade as a consultant. He had failed to do so. The fact that the amounts had been subject to corporation tax in the hands of the companies was irrelevant.

The taxpayer's appeal was dismissed.

Comments – This is yet another case in recent months where the taxpayer has lost the argument before the Tribunal because of the lack of evidence in respect of expenditure. Taxpayers need to be aware that expecting a Tribunal to grant relief on the basis of no or little evidence is the weakest of all cases and is unlikely to succeed.

G Bianchi v HMRC TC4442

Exchange rate losses and the freedom of establishment

Summary - The CJEU found that domestic provisions which resulted in the non-deductibility of exchange rate losses were compatible with EU law.

X AB, a Swedish company, held 45% of the shares in Y Ltd, a UK company; and its shares were issued in US dollars. X AB planned to transfer those shares. This presented a risk of currency loss, as X AB had contributed capital, in cash, to Y Ltd at an exchange rate more favourable than that existing at the time of the transfer. Under Swedish tax law, capital losses on 'holdings for business purposes' are not deductible from the basis of assessment for corporation tax. X AB contended that such an exclusion was not compatible with the freedom of establishment (TFEU art 49) when it applied to a capital loss resulting from a currency loss on a 'holding for business purposes' in a company resident in another member state of the European Union.

Decision:

The CJEU found that capital losses on the transfer of 'holdings for business purposes', and which have their origin in a currency loss, could not be deducted whether the shares were held in a company established in another member state or in Sweden. Therefore, investments in 'holdings for business purposes' in a member state other than Sweden were not treated more unfavourably than similar investments effected in Sweden.

Comments - In the absence of discrimination, the CJEU observed that the TFEU cannot be interpreted as requiring member states to adapt their own tax systems so as to take account of possible exchange risks faced by companies. These risks exist because of the continued existence within the European Union of a diversity of currencies between which there is no fixed exchange rate; and of national laws permitting the capital of companies to be denominated in the currencies of third countries.

X AB v Skatteverket C-686/13

A scheme to enhance DTR failed

Summary - The UT found that a scheme devised to artificially enhance double tax treaty relief did not work.

P&O, a UK company, was the parent of an international group. The principal holding company for the group, P&O Australia Ltd (POAL), was a wholly owned subsidiary of P&O, and held 99% of the shares in P&O Liena. POAL declared an interim dividend of A$75,000,000, which had been paid to P&O.

The group then implemented arrangements to ensure that the underlying tax attached to a payment of dividends to Liena was transferred by operation of the relevant provisions (mainly ICTA 1988 ss 790 and 799) to a dividend paid by Liena to POAL. The tax was then transferred again to the dividend paid by POAL to P&O, so that all of it would be treated as foreign tax.

P&O argued that the fact that the company, which had paid the original dividend to Liena, had not itself incurred the tax was irrelevant, as the amount of underlying tax for which double tax relief was available was determined by the mixer cap.

Decision:

Under ICTA 1988 s 790(6), 'any tax in respect of its profits paid … by the company paying the dividend shall be taken into account in considering whether any, and if so what, credit is to be allowed'. The UT stressed that s 790(6), like s 799(1), referred to 'tax paid' and could not apply to deemed tax; therefore, where there was no foreign tax, there was also no tax which could be taken into account. Furthermore, the mixer cap of s 799(1A) did not come into play if the gateway in s 799(1) was closed.

Finally, the first POAL dividend could not realistically be said to represent dividends which were not even in contemplation when it was declared and paid so that the required tracking of underlying tax required byICTA 1988 s 806 was not possible.

Comments - The taxpayers (and their advisers) seemed to have relied on a mechanistic approach to the legislation, so that a *Ramsay* challenge would be unlikely to succeed. The scheme was however defeated because 'it did not work' without the need for a recharacterisation under *Ramsay*.

Peninsular & Oriental Steam Navigation Company v HMRC [2015] UKUT 312

European Commission launches action plan for fairer and more efficient corporate tax

The European Commission has published a timeline for the measures in its action plan for corporate taxation. It launched this with a public consultation on the disclosure of tax information and a list of non-cooperative jurisdictions.

The Commission will introduce a new proposal providing a staged approach to a common consolidated corporate tax base (CCCTB) in 2016. Under the previous proposal for a CCCTB, multinational enterprises could choose whether they should apply it. However, the Commission now intends that, if it is brought in, the CCCTB will be mandatory for all multinational enterprises.

The first step would be a common corporate tax base with a cross border loss offset regime. This would include a recapture mechanism when the entity surrendering losses is profitable again so that losses are not permanently shifted to another Member State.

The action plan explicitly states that the harmonisation of corporate tax rates is not part of the agenda. In the long term, the Commission continues to aim for a full CCCTB with tax consolidation across Member States such that intragroup transactions are ignored and profits shared between Member States by a formula, probably based on the geographical distribution of sales, labour or assets. We understand that the UK does not consider CCCTB an attractive proposal.

Under the action plan, the Commission also intends to take forward various other steps in the interim including:

- Automatic exchange of information between EU tax authorities to start on 1 January 2016
- Agreement by mid-2016 on implementing the base erosion and profit shifting (BEPS) agenda by turning the OECD Actions on permanent establishments and controlled foreign companies into binding EU rules
- Amending the Interest and Royalties Directive so that withholding tax is allowed where payments are subject to 'no effective tax elsewhere in the EU'; also, amending the Parent-Subsidiary Directive to align it with the recast Interest and Royalties Directive
- Enforcing the 'modified nexus approach' for preferential regimes such as patent boxes, if this proves necessary
- Proposing improvements to the current mechanisms to resolve disputes in respect of double taxation matters by summer 2016 with clearer rules and more stringent time lines

As an annex to the action plan, the Commission has published a list of the 30 jurisdictions that appear most often in Member States blacklists of uncooperative territories. Over the next two years, it is intended to examine potentially non-cooperative jurisdictions with the view of helping them improve their governance standards.

The Commission also launched a consultation on additional disclosure obligations for corporate tax information. This includes a number of options including public disclosure of country-by-country information and/or public statements by businesses of their tax policies. This might consist of extending the current country-by-country disclosure obligations for financial institutions to all sectors. Other options include publishing aggregated/anonymised information or just implementing the plans for disclosure between tax authorities that are part of the OECD's BEPS project.

It should be noted that direct tax provisions generally require unanimous agreement from Member States, although it might also be possible for the enhanced cooperation mechanism to be used by willing Member States as is happening with the financial transaction tax.

European Court judgments due on VAT position of holding companies and VAT liability of extended warranties

On Thursday 16 July 2015, the Court of Justice of the European Union (CJEU) is set to release two significant VAT judgments: the joined cases of *Beteiligungsgesellschaft Larentia + Minerva mbH & Co. KG* and *Marenave Schiffahrts AG* (Larentia and Minerva); and the case of *Mapfre Warranty SpA*(Mapfre).

In the Larentia and Minerva case, the Advocate General (AG) held that, where a holding company is actively involved in the management of a subsidiary and it incurs costs in relation to capital transactions connected to that subsidiary, the VAT on this expenditure can be recovered in full and does not need to be apportioned between business and non-business activities. This is in line with the historic treatment in the UK but conflicts with guidance issued by HMRC last year, which proposed restrictions on the basis of the business/non-business split and also required a full recharge of costs. The case also considers VAT

grouping eligibility conditions, on which the AG opined that all 'persons' can be included in a VAT group and that the German VAT grouping rules are too restrictive.

The Larentia and Minerva judgment will be significant for many businesses with holding companies in VAT groups and HMRC has already indicated that it will review its recently updated policy once the final judgment has been released. The case might also cast doubt on the UK's VAT grouping eligibility rules which, for instance, prevent limited partnerships from joining VAT groups.

In the Mapfre case, the AG opined that used car mechanical breakdown warranty services supplied by Mapfre to the purchaser of the vehicle fell into the category of insurance and should have been treated as exempt from VAT. In the event that the CJEU follows the AG's opinion, businesses in the EU involved in supplying warranties on goods which are treated as taxable service contracts may wish to consider the implications of the case further, particularly as HMRC has indicated that it may review the VAT liability of extended warranties following the judgment

OECD releases document on implementation of country-by-country reporting (CBCR)

The OECD has released measures for the implementation of CBCR under base erosion and profit shifting Action 13 (guidance on transfer pricing documentation and country-by-country reporting). The package contains model domestic legislation designed to implement CBCR for the ultimate parent entity of a multinational group in its jurisdiction of residence and a proposed multilateral competent authority agreement to implement CBCR information exchange. CBCR would apply for fiscal years beginning on or after 1 January 2016, and would need to be filed within 12 months of the relevant year end. Groups with total consolidated revenue of less than €750 million and wholly domestic groups would be excluded from CBCR requirements. It is intended that the reports would be machine-readable and so groups will need to ensure that they have the capability to submit reports in the required format.

The report would normally be filed by the ultimate parent of the group in its country of tax residence. Where that jurisdiction does not require CBCR or does not have a qualifying competent authority agreement in place, individual group entities would be required to file in their countries of residence, unless a surrogate parent entity has been appointed by the group to file reports.

In relation to UK implementation, the relevant enabling legislation for CBCR was included in Finance Act 2015 with the detailed rules to be published by way of regulations. HMRC has previously stated that such regulations would be made once the OECD has completed its relevant work and would be subject to a period of consultation. Given the publication of the OECD implementation package, draft regulations can be expected soon.

The OECD's model legislation requires that the reports should be treated as confidential by tax authorities. However, there continue to be calls from certain bodies for CBCR to be made public.

With reports due for periods beginning on or after 1 January 2016, groups which have not yet considered how best to gather the required data and what perception it is likely to convey are encouraged to do so.

VAT

Supreme Court decides that VAT planning scheme was abusive

On 10 June 2015, the Supreme Court released its judgment in the case of *Pendragon plc and others*. This case concerns whether a complex financing scheme entered into by a major car dealership group constituted an abusive practice liable to redefinition under the Halifax doctrine (which addresses the scope of the EU principle of abuse of rights in the context of VAT). One outcome of the scheme was intended to be the ability to sell certain cars without having to charge VAT on the full selling price, where VAT had been deducted on their purchase.

It was common ground that the scheme technically worked. However, HMRC contended that the scheme was wholly artificial, did not reflect economic reality and was set up with the sole or essential aim of obtaining a tax advantage of a kind which was contrary to the purpose of EU law (ie, an abusive practice). HMRC, therefore, sought to recover the VAT which the taxpayers' group avoided under the scheme. The First-tier Tribunal had previously held that the scheme was not abusive, but the Upper Tribunal held that it was. The Court of Appeal subsequently held that the First-tier Tribunal was entitled to come to the conclusion that the arrangements were not abusive, and that the Upper Tribunal was wrong to reverse the decision. The Court of Appeal, therefore, allowed the taxpayer's appeal and restored the decision of the First-tier Tribunal.

The Supreme Court has unanimously allowed HMRC's appeal, holding that the scheme was indeed abusive. Specifically, the Supreme Court held that the scheme was designed to exploit EU law so as to prevent any taxation on the sale of the cars. Further, certain features of the scheme had no commercial rationale other than the achievement of a tax advantage. Having concluded that the scheme constituted an abusive practice, it followed that the transactions fell to be redefined. Accordingly, the Supreme Court held that the taxpayers' group was liable to account for VAT on the full selling price of the cars.

This judgment serves as a reminder that, whilst transactions may have a legitimate commercial purpose, the method of achieving that purpose may be open to challenge if the accrual of a tax advantage constitutes the principal aim of those transactions.

VAT: offshore transfer of a business and the Halifax principle

Summary - The UT found that the offshore transfer of a business to avoid incurring irrecoverable VAT was not abusive.

Ocean Finance had transferred a loan broking business to Alabaster, a company resident in Jersey, which outsourced the processing operations back to the UK. Prior to the move, Ocean Finance had incurred irrecoverable VAT on advertising, as it only had made exempt supplies. The purported effect of the move was that the supplies made by Ocean Finance were made in the UK (where the recipients belonged) and therefore remained exempt. However, the advertising services were treated as not subject to UK VAT, as both the supplier of the services and Alabaster belonged in Jersey. The issue was whether the scheme was abusive under the *Halifax* principle.

Decision:

The UT observed that a departure from the contractual position was only justified if there was an abusive practice. On that basis, it was not open to establish that the relevant supplies were made to and by Ocean Finance without the need to redefine the contractual arrangements. There would be abuse if the scheme comprised 'wholly artificial arrangements which did not reflect economic reality'; or if 'the contractual terms constituted a purely artificial arrangement which did not correspond with the economic and commercial reality of the transactions', and the sole aim of the transaction was to obtain a tax advantage.

Agreeing with the FTT, the UT found that the question was whether the structure (and the transactions within it) gave rise to abusive practice in the context of the overall factual matrix. The question was not whether the change in structure resulted in a tax advantage, as compared with the pre-existing structure. Furthermore, the fact that a change of structure was wholly tax driven did not mean that the resulting structure, had it been set up initially, would have given rise to an abusive practice. It was perfectly acceptable for a Jersey resident company to outsource its processing operation to a UK resident company.

Comments - The UT accepted that there was no commercial justification for Ocean Finance to cease to carry on business as a loan broker and that the structure would not have been put in place apart from the tax advantages. However, this was only relevant to the second limb of the *Halifax* test (what was the sole aim of the arrangements); and not to the question of whether those arrangements were wholly artificial and did not reflect the economic and commercial reality of the transaction.

HMRC v Paul Newey t/a Ocean Finance [2015] UKUT 0300

Fleming claims and uncertain quantum

Summary - The UT found that a historic repayment claim must fail due to lack of evidence.

The appeal concerned a *Fleming* claim by an NHS Board to recover input tax paid on capital expenditure during a 23 year period. The appeal had been refused by the FTT, on the ground that the appellant had failed to prove to an acceptable standard what amount, if any, of unrecovered input VAT had been paid by it on capital expenditure over the period. The issue was whether the FTT had erred in law in refusing the appeal on that ground.

Decision:

The UT observed that contemporaneous bookkeeping practices had failed to identify whether expenditure was VAT inclusive or exclusive; and that there were no reliable records of input tax recoveries made contemporaneously during the years to which the claim related. The FTT had therefore been entitled to find that the appellant had not made its case.

The UT rejected, inter alia, the contention that the FTT had required an 'unreasonably high standard of accuracy', in circumstances where the material placed before it had not been of sufficient value to enable any conclusion to be drawn whether by way of estimation, assumption, extrapolation or otherwise.

Comments - The FTT accepted that the Lothian NHS Health Board had a valid claim; however, in the absence of acceptable evidence as to its quantum, the claim must fail. There was also no reason to adopt a lower standard for historic claims.

Lothian NHS Health Board v HMRC [2015] UKUT 0264

Energy saving materials exemption does not comply with EU law

Summary - CJEU found UK reduced rate on energy saving materials breached Principal VAT Directive.

The European Commission was seeking a declaration that by applying a reduced rate of VAT to supplies of services of installing 'energy saving materials', and to supplies of such materials by a person who installs those materials in residential accommodation, the UK and Northern Ireland had failed to fulfil their obligations under the principal VAT Directive art 98.

Decision:

The CJEU noted that the principal VAT Directive precludes national measures, which extend the reduced VAT rate system to situations that are outside the social context. It rejected the UK's argument that the aim of the reduced rate for energy saving material was to improve the quality of housing and the health of the people living in that housing. It explained that in the absence of differentiation according to levels of income, age or other criteria, the provisions could not be regarded as being adopted for social reasons.

Comments - In the wake of this decision, the UK is likely to amend the legislation on energy saving materials, thus removing a competitive advantage for many suppliers.

Ian Carpenter, Baker Tilly's head of VAT, said that, having removed the VAT reduced rate to the installation of energy-saving materials in charitable buildings, the government must have expected that the decision would go in its favour because “the recent Queen's speech made it clear that new legislation would ensure that there would be no extension to the scope of VAT. This judgment appears to have scuppered those plans.”

He added: “We will now have to await how the government will interpret and react to this decision. It may determine that only social housing tenants can be provided with the supply and installation of energy-saving materials at a reduced rate, and that consequently owner-occupiers must pay VAT at the standard rate. It may also need to find a more efficient way of promoting energy-efficient materials while remaining in line with EU VAT law, possibly through the use of direct subsidies. Without addressing such issues, the undoubted impact will be a significant rise in costs for consumers and others installing energy-saving materials in residential homes.”

European Commission v UK and Northern Ireland (C-161/14)

Scope of the fund management exemption

Summary - The advocate general (AG) opined that the VAT exemption for the management of certain special investment funds can apply to those investing in real estate.

X was a Dutch fiscal entity made up of several companies. One of those companies, A, provided various services to a company set up by pension funds to invest in real estate. The company did not have any employees; and therefore the services provided by A included the management of the real estate, as well as more administrative tasks.

The first issue was whether a company set up to invest in real estate assets could be considered as a special investment fund exempt from VAT (Principal VAT Directive art 13B). The second issue was whether the VAT exemption which applies to management services could apply to the effective management of real estate outsourced to a third party.

Decision:

The first issue was whether a company set up to invest in real estate assets could be considered as a special investment fund exempt from VAT (Principal VAT Directive art 13B). The AG thought that this was the case, provided that the company was subject to specific state supervision.

The second issue was whether the VAT exemption which applies to management services could apply to the effective management of real estate outsourced to a third party. The AG considered that this was the case, as this would preserve fiscal neutrality since a direct investment in real estate would be exempt.

Comments - For funds operating in exempt sectors, such as health care and student accommodation, management fees give rise to irrecoverable VAT. Should the CJEU decide to follow the opinion of the AG, this would represent a substantial saving. However, this could adversely affect the VAT position of fund managers.

Staatssecretaris van Financiën v Fiscale Eenheid X (C-595/13)

Cessation of partnership and VAT liabilities

Summary - The FTT accepted that a partnership had ceased trading.

It was accepted that the partnership had been terminated by 18 August 2010. The issue was whether the partnership had been terminated before that date.

Decision:

The FTT noted that the effect of VATA 1994 s 45(2) was that a partnership between two people was to be treated as remaining in existence until it actually ceased and notice of cessation was given to HMRC.

The FTT accepted Mr Lye's evidence that the notice of cessation had been posted to HMRC on 3 May 2008. Given that VATA 1994 s 98 allowed the posting of such notices, the notice was deemed to have been received in the ordinary course of the post on 5 May 2008 (Interpretation Act 1978 s 7).

The remaining issue was whether the partnership had actually been dissolved on 1 May 2008. The FTT observed that, under the Partnership Act 1890, a partnership can be dissolved by one partner giving notice to the other partners. From that point, the partners retain certain powers and obligations for the purpose of winding up the business; for instance, completing contracts entered into prior to the effective date of dissolution. However, the business is no longer carried out with a view to profit and so the partnership no longer exists.

The FTT relied on Mr Lye's evidence, as well as his letter to HMRC dated 3 May and the date on the separation agreement, to conclude that the partnership had been dissolved on 1 May 2008. Consequently, no VAT arising after 1 May 2008 could be assessed on the partnership.

Comments - HMRC sought to ascribe VAT to the partnership as it had remained active after the date of dissolution. Partners of a dissolved partnership should therefore ensure that, after the date of dissolution, they limit their activities to completing contracts entered into before the date of dissolution. Any new contracts must be carried out in the name of a single partner (or of a new entity) to avoid any suggestion that the partnership is still trading.

Gordon Lye v HMRC [2015] UKFTT 0206

Supplies of promotional campaign management

Summary - The FTT found that supplies of promotional campaign management services were single, standard rated supplies.

The Marketing Lounge's business was sales promotion and the assessment related to five promotional campaigns for its clients, which were major public companies. These campaigns offered various incentives to existing and new customers, including 'one night free' hotel offers, free spa and beauty treatments, etc.

The Marketing Lounge contended that it provided two supplies: a zero rated supply of printed material, such as guide books listing hotels; and a standard rated supply of 'fulfilment services', which was ancillary. The latter supply involved the management of the incentive scheme; for instance, the manning of telephone helplines. Both supplies should therefore be zero rated. HMRC considered, however, that the whole supply should be taxed at the standard rate.

Decision:

Referring to *Card Protection Plan* (C-349/96) and *Levob* (C-41/04), the FTT noted that the economic nature of the supply and the viewpoint of the customer were key. The FTT found that all the elements were part of a whole. By engaging the Marketing Lounge, the clients were relieved of the whole responsibility of running their campaigns and a sub-division would be artificial.

Furthermore, the printed material was a subordinate and incidental part of the promotion. The Marketing Lounge was therefore making single, standard rated supplies.

Comments - This case is a practical example of the application of the *CPP* and *Levob* principles. The viewpoint of the client is key when deciding whether he is buying single or multiple supplies.

The Marketing Lounge Partnership v HMRC [2015] UKFTT 219

The partial exemption and farming business

Summary - The FTT found that construction works were solely attributable to exempt supplies.

Mr and Mrs Kumar were partners in NK Motors. The partnership held a number of properties, including Jesse Farm. NK Motors had granted a licence to a company owned by Mr Kumar which ran a 'DIY livery business', under which stabling space was made available to local residents. Mr Kumar had not elected to waive the exemption in relation to Jesse Farm so that the supply of the licence was exempt. The partnership also made taxable supplies so that the partial exemption applied.

Mr Kumar had carried out a wide range of construction works on the farm and the issue was the recovery of input tax in relation to barn repairs. HMRC considered that the cost of the barn repairs was entirely attributable to the exempt supply of the licence; whereas Mr Kumar contended that the barn repairs were also attributable to taxable supplies. Mr Kumar pointed out that he sold eggs on the barn premises; that prior to the barn conversion, the barn had been used for the taxable supply of storage space to motor vehicles; and that he had always intended to use the farm as a working farm.

Decision:

In relation to the sale of eggs, the FTT found that the factual evidence suggested that Mr Kumar had neither been carrying out this business, nor held the intention of doing so, at the time of the works. The FTT accepted that the barn had been used for car storage. However, there was no evidence that Mr Kumar had charged for this service and, in any event, it was likely to have been an exempt supply of land in the form of a licence. Additionally, there was no 'direct and immediate link' between the conversion of the barn and the storage of cars.

Finally, the FTT accepted that Mr Kumar had intended to use Jesse Farm as a working farm and had only set up the DIY livery business because of financial difficulties. However, the evidence did not specify how the barn would be used for future farming and so the required 'direct and immediate link' was absent.

The FTT concluded that the barn repairs were solely attributable to exempt supplies.

Comments - This case is a practical example of the way the FTT will approach the attribution of input tax between taxable and exempt supplies. In particular, a 'direct and immediate link' is crucial between the the input tax and the supply it is supposed to facilitate.

NK Motors v HMRC [2015] UKFTT 201

Agency not established

Summary – The Trbunal held that the taxpayer was acting as principal rather than as agent

The taxpayer bought tickets to musical, theatrical and sporting events at the request of clients and included in the price charged for the ticket a commission for his time and travel costs.

HMRC said he was making a taxable supply of tickets to his customers.

The taxpayer appealed. He said he was acting as agent and his turnover, for VAT, should be based on his commission rather than the gross payment received from the client.

Decision:

The First-tier Tribunal found that, although he only bought tickets to order for his clients, the taxpayer always purchased them in his own name. If customers had a problem with the ticket, they treated the taxpayer, rather than the entity from which he obtained it, as their supplier. Further, he took the financial risk that the customer may not pay for the ticket.

The judge concluded that these facts indicated that he was in effect buying and selling tickets at a profit; the taxpayer had not proved he was acting as an agent. On that basis he should be treated as acting in a principal capacity and the whole amount received for the ticket was liable to VAT.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, said: "The key challenge in situations like this is to review the contracts between the various parties and also the commercial reality of the arrangement. This is another example of how transactions involving three parties can go wrong as far as VAT is concerned. All arrangements of this nature need to be considered very carefully."

R Asquith v HMRC TC4319

Free supplies of entertainment

Summary - The FTT found that there had been no free supplies of business entertainment by the taxpayer.

HMRC contended that sums payable by Merlin Scientific (MSL) for the provision of meeting facilities predominantly related to the provision of business entertainment free of charge to the clients of MBL (a company associated with MSL). Accordingly, the relevant proportion of the overall supply should be excluded from credit for input tax (VAT (Input Tax) Order 1992 art 5).

Decision:

Applying *Card Protection Plan* C-349/96, however, the FTT found that the supply by MSL to MBL was a composite supply of services, which consisted of a principal supply of consultancy services and an ancillary supply of corporate meeting services (including a minimal amount of business entertainment), invoiced to MBL. This led to the 'inevitable conclusion' that the supplies of business entertainment were

not provided free of charge. The corporate meeting services were provided to MSL, which made an onward supply of those services to MBL, along with the provision of its consultancy services. This composite supply was taxable at the standard rate.

Finally, the direct tax treatment followed the VAT treatment so that these expenses were allowable in full, as they had been wholly and exclusively incurred for the purposes of MSL's trade.

Comments - This case highlights the importance of identifying the supplier and the recipient of each supply in order to ascertain the VAT position. Some entertainment services were provided free of charge by MBL; however, this was irrelevant to the VAT position of MSL, which charged MBL for the services it provided.

Merlin Scientific v HMRC [2015] UKFTT 247

TOGCs and the option to tax property

Summary - The FTT found that the sale of a business relating to property could not be treated as a transfer of a going concern (TOGC), if the purchaser had exercised the option to tax but failed to notify HMRC by the time of the sale.

Mrs Harris owned a hairdressing salon which she rented out. She was registered for VAT and had opted to tax the hairdressing salon. She had sold the building to her daughter on 1 August 2011 and the issue was whether the sale of the hairdressing salon had been a TOGC so that no VAT was due.

Mrs Harris' daughter had registered for VAT with effect from 1 August 2011. She had exercised the option to tax (although she had not notified HMRC) and she had charged VAT on rental payments. The question was therefore whether the VAT (Special Provisions) Order 1995 art 5(2A) (a) requires not only that an option to tax has been exercised by the transferee on or before the date of the transfer, but also that notification of that option has been given to HMRC. HMRC contended that a belated notification would not satisfy the requirements of art 5(2A)(a).

Decision:

The FTT agreed, noting that art 5(2A) (a) could have referred to the time limits ofVATA 1994 sch 10 para 20. The FTT inferred from this omission that Parliament must have seen the 'benefit of a more rigorous approach in the specific context of the transfer of a going concern, as against an option to tax in the ordinary course of a trader administering his ongoing VAT affairs'.

Comments - The case is a reminder that the vendor of a property business, who wishes the sale to qualify as a TOGC, should ensure that the buyer warrants in the sale agreement that he has not only exercised the option to tax, but that he has also notified that option to HMRC before completion.

Nora Harris v HMRC [2015] UKFTT 265

Investment services input tax partially deductible

Summary - The UT found that input tax incurred on investment services was partially deductible.

The university is a charity; and its main activity is the provision of exempt supplies of education. It also makes taxable supplies, including commercial research, sales of publications, catering and accommodation. The university invests donations and endowments in a fund which, in turn, invests in a range of securities, generating income that the university uses to support all of its activities. The issue was whether the fees charged by the fund should be characterised as overhead expenditure, attributable to the university's economic activity as a whole. This would allow the university, as a partially exempt trader, to deduct a proportion of the VAT.

Decision:

Agreeing with the FTT, the UT found that whether the fund was engaged in income or capital generating activities was not relevant to the issue of whether the input tax related to overheads, as the VAT treatment of transactions does not depend on whether they are income or capital generating. Referring to *Kretztechnik* (C-465/03), the UT pointed out that the question was whether the supplies had been acquired in connection with an activity carried out for the benefit of the university's economic activity in general. As this was the case, the cost of the fund's supplies was an overhead.

Finally, the UT rejected the contention that the disposal of investments by the fund was a chain breaking event, so that the necessary link between input tax and taxable supplies could not be established. The services supplied by the fund were not linked to any particular supply by the university because the investment activity was not carried out for its own sake but for the benefit of the university's other activities.

Comments - This case confirms that in the absence of a direct and immediate link between the goods or services in respect of which VAT is incurred and taxable supplies, the taxpayer will be able to deduct VAT when the costs incurred to acquire the goods or services are part of the general costs of its overall economic activity.

HMRC v University of Cambridge [2015] UKUT

Is the supply of a motor caravan the supply of a caravan?

Summary - The FTT found that motor caravans were not caravans for the purpose of VAT zero rating.

The issue was whether motor homes or motor caravans could be properly described as 'caravans' for the purposes of VATA 1994 Sch 8 Group 9 item 1, so that their supply was zero rated.

The FTT noted that HMRC's definition in *VAT Notice 701/20* was not relevant. Additionally, the definition contained in the Caravan Sites and Control of Development Act 1960 (referred to by HMRC) should not apply, as Parliament had chosen not to refer to it in the context of VAT (in contrast to its specific adoption for other tax purposes).

Decision:

The FTT considered that it must decide whether, in accordance with the ordinary usage of the English language, the word 'caravan' in the context in which it appears was apt to include motor caravans. The FTT observed that the fact that some vehicles were called 'motor caravans' did not make them a subset of a wider category of caravans. Second, the English usage of the word 'caravan' did not encompass motor vehicles. Third, the size qualification had been set by reference to the size limits of towed vehicles, so a caravan must be a vehicle relying on an external source of locomotive power rather than a self-propelled vehicle. Finally, the fact that both a motor caravan and a caravan offered living accommodation did not justify treating them in the same way for VAT purposes.

Comments - The FTT gave no weight to HMRC's definition of caravan and found that it was wrong. The case is also a useful example of the way a tax tribunal will ascertain the intention of Parliament.

Oak Tree Motor Homes v HMRC [2015] UKFTT 251

Whether confiscated goods should be restored

Summary - The UT found that a decision not to restore a confiscated bag was flawed as proportionality had not been considered.

The appellant had wished to purchase an alligator skin handbag in the US. She had arranged for the bag to be purchased in the US and brought to the UK by a friend. On arrival at Heathrow, the bag had been duly declared through the red channel. Purchase documents and a CITES certificate (issued under the Convention on International Trade in Endangered Species of Wildlife Fauna and Flora) had been produced. However, under the CITES convention and associated European legislation, both a US export certificate and a UK import certificate were also required. As these were not produced, the bag (which had cost $38,200) had been confiscated and had not been returned.

Decision:

The UT noted that the question was whether the goods should be restored, despite the fact that they were illegally imported and validly forfeited. This depended on proportionality. Since the FTT had not dealt with the issue of proportionality, the appeal must succeed. Rather than remitting the appeal to the FTT, the UT ordered a further review by the Director of Border Revenue, suggesting that a review by a different officer would be a 'very good idea'. However, the UT turned down the appellant's invitation to make some positive directions about proportionality.

Comments - After *Sabine Smouha v The Director of Border Revenue*, this case is another example of a border officer's misunderstanding of the law. It is also a Kafkaesque example of bureaucracy. The UK authorities would not grant a retrospective certificate without the US authorities producing one first; and the US authorities would not do so as they had heard that the UK would not grant such a certificate.

Putri Projosujadi v Director of Border Revenue [2015] UKUT 297

Input tax claims: purpose v benefit – what the courts say (Lecture B904 – 14.47 minutes)

The word 'purpose' is prominent in the VAT legislation with regard to input tax (see Box 1), possibly the most important of all, along with the phrase 'direct and immediate link,' which I will also consider.

Imagine the following situation: a business owner wants to claim input tax on his golf club membership – his argument is that he has picked up a lot of work from fellow members and therefore a claim can be justified he thinks. However, the reality is that even though the membership might 'benefit' his business, the 'purpose' of the expense is because he enjoys playing golf.

Box 1 – VATA 1994, s24(1)…..defines "input tax" as:

(a) VAT on the supply to him of any goods or services; (b) VAT on the acquisition by him from another member State of any goods; and (c) VAT paid or payable by him on the importation of any goods from a place outside the member States, being (in each case) goods or services used or to be used for the purpose of any business carried on or to be carried on by him.

Hobby or business?

In the recent First-tier Tribunal case of Lai's Ltd (TC3352), Mr Lai was a successful entrepreneur who had bought and sold many Chinese restaurants in the Devon area. He developed an interest in powerboat racing in 2006, and had already purchased two boats before the third purchase in 2010, taking part in a variety of races. He paid £290k for the third boat and claimed input tax of £31k by buying it as an asset of his company. He claimed that the 'purpose' of the expenditure was to enable him to win catering contracts to supply food at world powerboat championship events, known as P1 events. He felt that he needed to show himself as a serious powerboat enthusiast to have any chance of winning the contracts. I smiled at his logic, which seemed to me a bit like someone justifying committing a crime on the basis that it would help their future application to become a policeman! There were six events a year and Mr Lai had a plan to organise local staff to assist with the food at each venue, and he considered it would be a profitable venture.

However, the tribunal rejected the business purpose argument and commented that:

"Mr Lai was an astute businessman. He would have known a dicey proposition when he saw one, and would have been able to distinguish it from a real business venture. This was a dicey proposition…………Therefore, because the commercial benefit was remote, in order to spend such an amount on the boat he must have had in mind the other benefits which came from acquiring the boat."

A key problem for Mr Lai was that he had a strong personal interest in powerboat racing, and therefore it was easy for both HMRC and the tribunal to conclude that the 'purpose' of the expenditure was linked to private rather than business motives. The fact that he had already bought two earlier boats for racing purposes supported this conclusion.

So if any clients incur expenditure on projects that seem to offer little scope for making a profit, or contributing to profit, or do not seem to give good value to the business (a small logo advertising a business on a racing car would not really justify the business treating all of the racing car costs as a business expense and would almost certainly not provide a good return on its advertising budget), then the chances are that it is a hobby linked to the business owner or one off his family rather than a serious business proposition.

Folkestone Harbour (GP) Ltd (TC4306)

The company paid for the construction of an impressive new 'pavement fountain' at the entrance to a harbour that was being redeveloped and claimed input tax of £89,193 on the expenditure, which HMRC disallowed (and also charged interest of £4,715) on the basis that it did not relate to a business purpose and for taxable supplies. The taxpayer claimed that there was a clear business purpose because the fountain acted as a 'marker' for the redeveloped harbour and was a 'significant' part of the project. HMRC claimed that the fountain was 'remote from the development area' and was an 'extension of a public thoroughfare' and was 'sited on the way out of the town as opposed to being at the entrance to the harbour'.

Note- the business activity of Folkestone Harbour (GP) Ltd was to construct and sell commercial and residential units at sites within the harbour, and also to rent out commercial units with an option to tax in place ie all taxable income.

The tribunal agreed with the taxpayer that the fountain was part of the proposed new site, rather than more closely associated with the town centre, and allowed the appeal.

HMRC are increasingly adopting the approach of trying to directly link an expense with a specific taxable supply rather than focusing on the more general issue of whether an expense is for a 'business purpose' as per s24(1), VATA1994. The tribunal recognised the marketing benefits of the fountain, and also its positive impact on property prices in the area, and that it gave the proposed redevelopment project a lot of credibility. The key issue in establishing a 'business purpose' is to assess the motives of the business claiming input tax when it agreed the expenditure in question – which was clearly linked to the harbour redevelopment in this case.

Direct and immediate link

Many businesses and charities have exempt income and non-business income or activities – and naturally want to seek to maximise input tax recovery within the rules. My approach is to encourage them to seek the link with 'taxable' supplies in order to justify a claim or partial claim, rather than look for a link with 'exempt' or 'non-business' activities to justify a non-claim.

As an example of this, a win in the courts for Buckingham Bingos Ltd (TC3093) saw the company successfully argue that 100% input tax could be claimed on the cost of prizes given to members who had a paid for a certain number of admissions to the club (taxable income) whereas HMRC claimed that the input tax was residual (only partly claimable) under the rules of partial exemption because some of the members then paid a further admission fee to play bingo (exempt income).

The taxpayer's view that the 'direct and immediate link' was only between the prizes and admission to the main premises was accepted by the tribunal.

Note – the phrase 'direct and immediate link' was first introduced as an important concept in the VAT world following the court case involving BLP in the European Court back in 1995 (ref: C-4/94). This case related to the input tax treatment in relation to the disposal of a subsidiary company by a share sale.

Other input tax rules

In a nutshell, every input tax claim made by a business, whether it be a 20p claim buying a new stapler for the office or a £20,000 claim on a piece of new equipment, needs to overcome six main hurdles:

- The expense must be for the 'purpose' of the business – as considered above
- There must be a 'direct and immediate' link to taxable supplies – as considered above
- The taxpayer must hold evidence to support the claim, usually a tax invoice (or less detailed tax invoice if the total expense is less than £250)
- The supplier must have charged VAT at the correct rate
- Only the business receiving a supply of goods or services can claim input tax
- There must have been an actual supply of either goods or services - see Example 1

Example 1

Jeff has been a tenant in a factory for 10 years and the lease has now expired, so he has vacated the property and moved to new premises. He has received a bill of £30,000 + VAT from the landlord to restore the factory to the same condition it was in when Jeff first became a tenant. The landlord has charged VAT because he has opted to tax his interest in the property.

In this situation, the VAT charge is incorrect and Jeff cannot claim input tax. The payment is effectively compensation to the landlord (dilapidation payment) and there has been no supply of goods or services in this situation from the landlord to the tenant. (HMRC Notice 742, para 10.13).

Article by Neil Warren

Planning tips with partial exemption (Lecture B905 – 16.20 minutes)

Case study: A property developer ABC Ltd has purchased the freehold of a building that comprises a ground floor shop and a first floor flat. The company's intention is to carry out some improvements and then find separate tenants to rent out the property on a long term basis (one tenant for the flat and another for the shop). What is the input tax position on the property costs? Can he keep things simple by charging VAT on the rent to both tenants so he can reclaim input tax on all of his costs?

An exempt supply cannot be made taxable by charging VAT

The first piece of good news is that there is no problem with the company making an option to tax election with HMRC, so that it can charge VAT on the rental supplies connected with the ground floor shop (form VAT1614A). However, an election is overridden in relation to those parts of a property that are residential ie the first floor flat – the rental income continues to be exempt. And even if the company incorrectly charged VAT to the tenant in the flat, it is still input tax blocked on related costs because it has still made supplies that are exempt within the legislation (VATA1994, Sch 9, Group 1). An exempt supply cannot be made taxable by incorrectly charging VAT!

So the company is partly exempt, and needs to consider its input tax position.

Standard method

A key tip is to encourage builders working on the project to identify their work as closely as possible to the two parts of the building – rather than just make a general charge to cover all areas of the building. This is because the direct attribution approach will ensure the input tax claimed is as accurate as possible ie so that a claim is made in connection with the ground floor shop but not on the first floor flat. The purchases invoices will then be divided into the usual three VAT categories:

- Costs that are directly relevant to the ground floor shop can be fully claimed for input tax purposes – as long as the company made the option to tax election with HMRC as mentioned above (taxable input tax)

- Costs that are directly relevant to the first floor flat cannot be claimed as they relate to exempt supplies (exempt input tax)

- Costs that relate to both parts of the building are apportioned, and with the standard method, this is based on the income split for the period in question ie taxable income (excluding VAT) divided by the total of taxable and exempt income (residual input tax)……T/T+E.

Standard method tips

Here are a couple of tips concerning the standard method:

- The amount of residual input tax claimed by a business is rounded up to the nearest whole number after the T/T+E calculation is carried out – so if the recovery percentage works out at 69.1%, then you claim 70%. The exception is if the total residual input tax exceeds £400,000 a month on average, in which case a calculation to two decimal places is needed. But that is a lot of input tax and only the big beasts of business will exceed it. The rounding up concession does not apply to 'special methods' where calculations are also made to two decimal places (HMRC Notice 706, para 4.7).

- Income from asset sales is always excluded from the T/T+E formula (HMRC Notice 706, para 4.8).

De minimis rules

Let’s return to ABC Ltd and here are some figures for the first VAT period to 30 September 2015 which consists of five months because the registration date was 1 May 2015:

- Taxable input tax = £3,000
- Exempt input tax = £2,500
- Note – the above figures include the residual input tax that has been apportioned with an income split calculation as considered above.

Your first thought might be to consider the partial exemption de minimis rules (quite rightly) and this is my next important tip: don’t forget that there are three de minimis tests and not one – and you only need to pass one of the three tests in order to fully reclaim input tax on all costs. The tests are:

1. Exempt input tax is less than £625 per month on average and also less than 50% of total input tax
2. Total input tax incurred is no more than £625 per month on average and the value of exempt supplies is no more than 50% of the value of all supplies
3. Total input tax incurred less input tax directly attributable to taxable supplies is no more than £625 per month on average and the value of exempt supplies is no more than 50% of the value of all supplies

So the good news is that ABC has passed the first test above and can reclaim all of its input tax for the September period (£3,000 divided by five months = £600 per month on average exempt input tax; exempt input tax is 45.4% of total input tax ie £2,500/£5,500).

Note – don’t forget that the total figure for exempt input tax comprises two elements – the input tax directly related to exempt supplies, and the proportion of the residual input tax that is not claimed. I have come across instances of advisers not recognising the residual input tax element – and incorrectly thinking there was a de minimis outcome.

Annual adjustment

Always be clear that when it comes to partial exemption, the quarterly figures are superseded by an annual adjustment – and the annual calculation is made up to the end of March, April or May, depending on when the VAT periods end for a business. In the case of a business submitting monthly returns, the key date is 31 March. So what does this mean in practical terms?

- It is possible for a business to be partly exempt in some periods throughout the year but then fully taxable when the annual adjustment has been calculated, meaning it can reclaim all of its input tax for the complete year.

- It is possible for a business to be fully taxable in some periods but then partly exempt when the annual calculation has been made ie meaning that the early gains on a quarterly basis are wiped out by the annual figures.

To give you a bit of technical jargon, the correct phrase for the annual adjustment is the ‘longer period’ because in some cases the period to be adjusted is not 12 months, as in the case of ABC Ltd whose annual period will be 11 months ie 1 May 2015 to 31 March 2016 (HMRC Notice 706, section 12).

Planning tip - split expenditure into two tax years

A number of years ago I was asked to give advice on a project being carried out by an estate agent, who intended to spend a lot of money improving his premises. In simple terms, most estate agents have taxable income from selling houses on a commission basis, and exempt income from acting as an intermediary in relation to the sale of financial products. And in most cases, the house selling is the predominant activity so they are usually de minimis in relation to partial exemption.

When we looked at the figures concerning his improvement costs, we worked out that he would have an extra source of exempt input tax of £3,000, which with his usual £5,000 of annual exempt input tax would push him over the de minimis figure for one tax year (> £7,500). The outcome? I suggested that he staggered the building work so that the extra £3,000 of exempt input tax would fall into two different tax years ie to avoid the £8,000 loss of VAT that he was faced with if the project only covered a single year.

The buy-to-let windfall

The partial exemption de minimis rules will hopefully enable many businesses (particularly sole traders) to claim input tax on the costs of a buy-to-let residential property they are renting out to tenants. See Example 1.

Example 1: Joan is VAT registered as a hairdresser (sole trader) and also owns a buy-to-let property (flat) in her own name ie the ownership is in the same legal entity as her business. She incurs a range of VATable costs in relation to the flat, including agent fees, repair costs and building improvements. Can she claim input tax on these costs through her hairdresser’s VAT registration?

Solution – the answer is ‘yes’ as long as the calculations mean that she falls within the partial exemption de minimis rules. Don’t forget that it is not the hairdressing business which is VAT registered – but Joan as an individual. She is the ‘taxable person’ not the hairdressing salon, and her VAT registration captures all of her business activities.

Note – the situation in Example 1 has produced a winning outcome for Joan because she does not use the flat rate scheme (FRS). But she would not have a good result with the FRS because the scheme would require her to account for FRS tax on her rental income. This is because the scheme captures all income earned by a legal entity unless it is outside the scope of VAT. So zero-rated sales are captured as well as exempt income eg rent.

As a final twist to the tale, always remember that jointly owned property is classed as a partnership for VAT purposes. So if Joan owned the property with her brother Steve, then the above issues with both input tax recovery and the FRS are irrelevant because there is now a different legal entity compared to her trading business.

Article by Neil Warren