Tolley®CPD

August 2015

Disclaimer

Tolley CPD takes every care when preparing this material. However, no responsibility can be accepted for any losses arising to any person acting or refraining from acting as a result of the material contained in these notes.

All rights reserved. No part of these notes may be reproduced or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior written permission of Tolley CPD.

Contents

Personal Tax 4
Profits from US LLCs and double tax relief 4
Dividends – the end of an era (Lecture B908 – 19.42 minutes) 5
Payment under compromise agreement 8
Protective assessments and the death of the taxpayer 9
Private use confusion 10

Capital Taxes 11
Interaction between EIS and CGT reliefs 11
IHT and main residences (Lecture P910 – 30.09 minutes) 12
Entrepreneurs' relief and Lloyd's Names (Lecture P908 – 6.31 minutes) 15
Scrip dividends and discretionary trusts (Lecture P909 – 14.36 minutes) 16
Abolition of bearer shares (Lecture P906 – 7.36 minutes) 18

Administration 20
Retrospective legislation lawful 20
Joint application for reference to CJEU declined 21
Estimated assessment 22
Confiscation orders and discovery assessments 22
Helpline failure – reasonable excuse 23
Judicial proceedings and tax appeals 24
How income tax revenue will change in Scotland 25
Deadline dates for August 2015 26

HMRC News 27
Employment intermediaries 27
Employee benefits and expenses 27
Capital allowances regulations 27
Deeds of variation 27
Non-dom IHT changes 28
Sporting testimonial income 28
Pensions relief reform consultation 28
Class 3A NIC regulations 28
Farmers' averaging profits period 28
National Insurance Contributions (Rate Ceilings) Bill 28
Government confirms Tax-Free Childcare launch date as it welcomes judgment from Supreme Court 28
Offshore tax evaders and the professionals who enable tax evasion will face even tougher sanctions. 29

Business Taxation 31
Losses update (Lecture P907 – 8.56 minutes) 31
Disallowable business expenditure (Lecture B907 – 9.43 minutes) 32
Annual investment allowances (AIAs) going forward (Lecture B906 – 8.49 minutes) 33
No more tax relief for goodwill amortisation (Lecture B909 – 8.33 minutes) 35
Claims for ACT credits were time-barred 36
Capital allowances schemes failed 37
Oil and gas company: gains subject to the supplementary charge 37

VAT 39
Flawed record 39
TOGCs and VAT groups 39
Gaming machines and the 'element of chance' 40
Was the redemption of vouchers an exempt supply? 41
Did the sale of a new building qualify for zero-rating? 42
Whether supplies made to company or to shareholders 42
Holding companies and input tax 43
Global accounting scheme 44
Educational aim 45
Warranty for mechanical breakdown is an insurance product 46
Forfeiture under a sale and leaseback 47
Is the transport of human organs and samples exempt? 47
So what is the VAT reverse charge? (Lecture B910 – 10.12 minutes) 48

Personal Tax

Profits from US LLCs and double tax relief

Summary - The Supreme Court found that a member of a US limited liability company (LLC) was eligible for double tax relief in the UK on his share of the profits.

Mr Anson was resident but not domiciled in the UK for UK tax purposes. He was liable to UK income tax on foreign income remitted to the UK.

He was a member of an LLC (a Delaware Limited Liability Company), which was classified as a partnership for US tax purposes. He was therefore liable to US federal and state taxes on his share of the profits. Mr Anson remitted the balance to the UK, and was therefore liable to UK income tax on the amounts remitted, subject to double tax relief.

HMRC considered that Mr Anson was not entitled to double tax relief, on the basis that the income which had been taxed in the US was not his income but that of the LLC. Mr Anson contended that, even assuming that US tax was charged on the profits of the LLC and that he was liable to UK tax only on distributions made out of those profits, the US and UK tax were nevertheless charged on 'the same profits or income', within the meaning of the UK/US double tax treaty. He also argued that, as a matter of UK tax law, he was liable to tax in the UK on his share of the profits of the trade carried on by the LLC, which was the same income as had been taxed in the US.

The First-tier Tribunal allowed the taxpayer's appeal, but the Upper Tribunal reversed its decision. The Court of Appeal agreed with the Upper Tribunal.

Decision:

The Supreme Court rejected the first ground, noting that the context of the treaty and its history did not suggest such a wide approach to the concept of income. However, in relation to the second ground, it found that Mr Anson was entitled to the share of the profits allocated to him, rather than receiving a transfer of profits 'previously vested in the LLC'. His 'income arising' in the US was therefore his share of the profits, which was the income liable to tax both under US law and under UK law — to the extent that it was remitted to the UK. His liability to UK tax was therefore computed by reference to the same income as was taxed in the US and he qualified for double tax relief.

Comments - The classification of foreign entities and of the profits they generate continues to raise difficult questions. In this case, the FTT had found that the members of the LLC had an interest in the profits as they arose; therefore, the Supreme Court found that double tax relief was due. It remains to be seen whether HMRC will consider that this applies to all LLCs or only to a specific category of LLCs.

David Treitel, managing director of American Tax Returns Ltd, said the decision followed “several years of tough argument, with HMRC taking the view that all US limited liability companies had the character of a corporation”.

The decision would “delight many investors”. Unless HMRC plan to look at every other state outside Delaware and the specific wording of every limited liability company agreement, “we should have the same treatment of such companies in the UK and the US”. Mr Treitel added that the ruling should also “encourage business between the UK and US by providing clarity and certainty for tens of thousands of UK investors investing in the US.”

Anson v HMRC [2015] UKSC 44

Dividends – the end of an era (Lecture B908 – 19.42 minutes)

The new regime

The announcement on 8 July 2015 of the death of the imputation system, which has been a key part of the UK tax code since FA 1972, with effect from 6 April 2016 was one of the Chancellor’s more surprising decisions in his Summer Budget.

In the words of HM Treasury found in Paras 1.185 and 1.186 of their Budget Report:

‘The current system of tax credits on dividends was designed over 40 years ago when corporation tax was more than 50% and the total tax bill on dividends for some was more than 80%. Since then, tax rates (including corporation tax) have fallen, leaving the dividend tax credit as an arcane and complex feature of the tax system.

Alongside further cuts to corporation tax rates for all businesses (over the next five years), the Government will reform and simplify the system of dividend taxation, while maintaining the extensive tax reliefs for investments held in ISAs and pensions. From 6 April 2016, the Government will remove the dividend tax credit and replace it with a new tax-free dividend allowance of £5,000 a year for all taxpayers.’

It is understood that the detailed legislation will not be available until the publication of the Finance Bill following the Autumn Statement later this year.

The position for individuals generally

In place of the previous regime, the Chancellor has unveiled a progressive series of dividend tax rates which will take effect for 2016/17 onwards. However, all dividends will benefit from an annual tax exemption of £5,000 – in other words, dividend income will only be liable to tax to the extent that the amount received exceeds this tax-free allowance (plus, of course, any available personal reliefs).

It is important to appreciate that the 1/9th tax credit will disappear. The amount received will become the gross figure.

Note that the £5,000 dividend allowance is separate from the previously announced £1,000 allowance for savings income (which excludes dividends and which is also due to come into force on 6 April 2016).

The table of rates for dividend income in 2016/17 (together with the comparative percentages for 2015/16) is as follows:

Taxpayer's marginal rate	Tax rate in 2016/17	Tax rate in 2015/16
Basic	7.5%	Nil
Higher	32.5%	25.0%
Additional	38.1%	30.6%

Thus, when a taxpayer's dividend income exceeds the £5,000 limit, the rate of tax applied to that income will be 7.5% higher across the board.

<u>Illustration 1</u>

John receives dividend income of £3,000 per annum. He is a 40% taxpayer.

In 2015/16, John will pay income tax of 25% x £3,000 = £750 on his dividends. In 2016/17, his dividend income will be tax-free on account of the £5,000 allowance.

<u>Illustration 2</u>

Susannah, John's wife, has a much larger share portfolio. Her annual dividend income is £22,000. Susannah is a 45% taxpayer.

In 2015/16, Susannah will pay income tax of 30.6% x £22,000 = £6,732 on her dividends. In 2016/17, the income tax will be on £22,000 – £5,000 = £17,000 @ 38.1% = £6,477. In other words, her dividend tax bill will also be lower.

However, if Susannah's dividend income was £62,000 per annum, the comparative tax figures are:

2015/16 (30.6% x £62,000)	£18,972
2016/17 (£62,000 – £5,000 = £57,000 @ 38.1%)	£21,717

This represents a substantial tax increase.

In Illustration 2, it would be worthwhile for Susannah to transfer some of her shares to John so that he could make full use of his £5,000 exemption in 2016/17.

The breakeven points for higher and additional rate taxpayers where their dividend income starts to suffer a greater tax burden on or after 6 April 2016 are:

40% taxpayer	£21,667
45% taxpayer	£25,400

Thus it is only individuals with significant dividend income who are going to be worse off under the new regime.

Family and owner-managed companies

The position for shareholder directors of family and owner-managed companies is less satisfactory, given that since the late 1980s many of these individuals have followed a 'low salary high dividend' profit extraction model which has normally been the most tax-efficient arrangement. The reason for this is simple: with a profitable company, a substantial proportion of the money taken out of the company is in the form of a dividend. Thus the tax bill in 2016/17 will be proportionately higher.

A review of the total tax costs (including corporation tax) of paying dividends out of a family or owner-managed company in 2016/17 produces the following results (in this instance, the £5,000 tax-free dividend allowance has been ignored):

	Shareholder		
	BR	**HR**	**AR**
Company profits	100.0	100.0	100.0
Less: Corporation tax @ 20%	20.0	20.0	20.0
Post-tax profits (ie. dividend)	80.0	80.0	80.0
Less: Dividend tax @ 7.5%/32.5%/38.1%	6.0	26.0	30.5
Net income	74.0	54.0	49.5
Effective tax rate	26.0%	46.0%	50.5%

Note: The effective tax rate for 2015/16 is 6% lower.

Where an owner manager wishes to pay a dividend to a spouse (who has no other income), a payment of, say, £37,500 would currently attract no tax. In 2016/17, a similar payment would cost a little over £1,600 after taking into account the tax-free dividend allowance. If that amount was paid to the owner manager himself (assumed to be a 40% taxpayer), the liability would be several times greater. Accordingly, a spousal payment will still be an appropriate tax planning strategy.

Looking ahead, many owner managers whose companies have sufficient reserves will clearly be keen to accelerate dividend payments to fall within the current regime rather than letting them be taxed in 2016/17. If the company needs the cash for working capital purposes, the money can always be transferred back to the company by way of a director's loan.

In view of the fact that corporation tax rates will fall to 19% in 2017 and to 18% in 2020, it seems probable that some shareholder directors will deliberately seek to retain more profits within their companies as an alternative to paying them out. Company purchase of own shares on a retirement, which should in most cases attract CGT treatment, will become even more commonplace. And what about shareholder directors taking out loans or advances from their companies via an overdrawn director's loan account? The Government have confirmed that they have no plans to increase the S455 CTA 2010 charge of 25% and an official rate of only 3% on beneficial loans may well be seen as entirely acceptable.

The final point to make is that, when doing a 'bonus v dividend' calculation for 2016/17, the gap between the tax-efficiency of the two options will have narrowed significantly. Dividends are likely still to retain a small advantage, but in many cases it will be virtually nip and tuck.

Contributed by Robert Jamieson

Payment under compromise agreement

Summary - The FTT found that a payment made to an employee under a compromise agreement was an emolument.

Mr Hill had been working for General Motors (GM) when his employment had been transferred from GM to Saab City under the Transfer of Undertakings Regulations, SI 2006/246. Mr Hill had been unhappy with the transfer of his employment, in particular because he was now working a long way from home, in breach of his employment contract. He had raised a grievance and a compromise agreement had been entered into. The issue was whether the payment fell within ITEPA 2003 s 403 so that it was exempt (as below the £30,000 threshold).

Mr Hill contended that he had not been paid to agree to a change in the terms of his contract of employment, but for agreeing not to pursue a claim for damages in respect of a breach of those terms.

Decision:

The FTT held, however, that in both cases the effect of the agreement between the parties was that, in return for receiving a payment, he had accepted that he would work far away from home. Furthermore, the compromise agreement required Mr Hill to refund all or part of the payment, in the event that he ceased to be employed by Saab City within two years of the payment; and this supported the proposition that the payment was an emolument.

Comments - Where the taxpayer's employment continued and he was paid because of a change in the conditions of his employment, the payment by his employers had to be treated as an emolument, regardless of the fact that it was made under a compromise agreement.

Andrew Hill v HMRC TC4480

Protective assessments and the death of the taxpayer

Summary - The FTT found that HMRC could pursue assessments against a taxpayer who had died.

On 2 June 2010, Mr Wood, a dentist, had attempted to make a disclosure under HMRC’s ‘tax health plan’ – a campaign that gave medical professionals an opportunity to tell HMRC about undeclared income by making a voluntary disclosure, in return for reduced penalties. HMRC had considered, however, that the disclosure was not covered by the terms of the Tax Health Plan and had opened a ‘COP 9 investigation’. Code of Practice 9 governs cases where fraud is suspected.

Following a meeting with HMRC, Mr Wood had agreed to commission a disclosure report into his tax affairs by September 2011. The report had not been produced and HMRC had issued assessments against which Mr Wood had appealed. He had died on 22 May 2013. Mr Wood’s widow, who was his personal representative, contended that she would not be able to contest HMRC’s allegations of deliberate behaviour by Mr Wood now that he had died. Therefore, requiring her to contest the disputed assessments would be in breach of the Convention on Human Rights art 6 (right to a fair trial) and would be contrary to the overriding objective of the FTT under Tribunal Procedure Rules (SI 2009/273) rule 2.

The art 6 argument could only succeed if HMRC’s disputed assessments amounted to charging Mr Wood with a criminal offence. His widow pointed out that the extended time limit of TMA 1970 s 36(1A)(a), which HMRC relied upon to raise the assessment, required the tax loss to have been ‘brought about deliberately’. This she thought, amounted to charging the taxpayer with a criminal offence.
Decision:

The FTT considered, however, that the effect of s 36(1A)(a) was simply to enable HMRC, upon proof of the deliberate bringing about of a loss of tax, to recover from the taxpayer what he should have paid, so that recourse to the extended assessment time limit was not penal in nature. The effect of the provision was not to condemn or punish. As for rule 2, the FTT found that the best achievement of the overriding objective would be obtained by not setting aside HMRC's assessments. The FTT stressed that the disputed assessments had been raised on a protective basis because the disclosure report had been delayed, and the liabilities under those assessments had crystallised before Mr Wood's death.

Comments - The FTT recognised that it was required to apply a very 'blunt tool' to a 'delicate situation'. It also accepted the difficulties of Mr Wood's widow. However, it felt that the litigation must follow its course, starting with the submission of the disclosure report.

Personal representatives of Mr Michael Wood (Deceased) v HMRC TC4474

Private use confusion

Summary – The Tribunal found that certain cars were likely to have been used privately and therefore needed to reported

Mr Holmes was the owner and managing director of KMS and his wife was a company employee. The company, which was run from a barn at the taxpayers' home, owned seven cars that had been used by the couple and other employees between 2003/04 and 2005/06.

An issue arose over the private use of the cars. The taxpayers denied that this had occurred, but acknowledged that the possibility existed that they might have been used for that purpose.

Decision:

The First-tier Tribunal said that, from the evidence of two meetings with HMRC, it seemed that Mr Holmes was unaware of the need to avoid private use or that there needed to be a complete prohibition on such use. He did not seem sure as to who owned the vehicles, apparently believing at one stage that he owned them personally.

The judge concluded that, in respect of five cars, private use was not forbidden and it was likely that the taxpayers had used them for private purposes. On the remaining cars, the tribunal said these were conventional company cars provided to other employees of the business. They had, in effect, not therefore been available to the taxpayers for private use.

The taxpayers' appeal was allowed in part.

Comments - The field of employment tax is a complex one and the reporting of benefits on a form P11D must be taken seriously. It was clear from this case that the taxpayer had not done so and did not know his responsibilities. He was lucky in his treatment.

M Holmes and T Holmes v HMRC TC4467

Capital Taxes

Interaction between EIS and CGT reliefs

Summary - The FTT dismissed the taxpayer's appeal against HMRC's decision not to allow his enterprise investment scheme (EIS) relief claim.

Mr Ames had invested in shares eligible for EIS relief. Mr Ames had, however, not claimed the relief because he had no taxable income in the relevant year. He had then sold the shares at a profit but had not included the gain in his return.

HMRC had amended the return to include the gain, on the basis that the CGT exemption was only available if EIS relief had been claimed (TCGA 1992 s 150A).

Mr Ames submitted that this interpretation of s 150 was 'anomalous' because Parliament had specifically inserted s 150A(3)(c) so that an individual could obtain full CGT exemption on disposal, despite having insufficient tax to utilise all of his EIS relief.

Decision:

Referring to Lord Hoffmann's eponymous article on 'Tax avoidance' [2005] BTR 197, the FTT noted that it could not 'rectify the terms of highly prescriptive legislation in order to include provisions which might have been included but were not actually there'. Parliament had amended s 150A with the object of allowing investors to obtain the full CGT exemption, even where their low income tax liability prevented them from making full use of the EIS relief, but Parliament had not detached the CGT exemption from the EIS relief.

Furthermore, there was no 'fundamental error' or other flaw in the statutory provisions which linked EIS relief with the CGT exemption, so that the European Convention on Human Rights was not in play.

Finally, the FTT could not allow a late claim under TMA 1970 s 118(2) which relates to 'anything required to be done' and not to claims which are optional.

Comments - The FTT dismissed the appeal. However, it noted that HMRC had the discretion to allow a late claim and pointed out that HMRC seemed to have failed to consider the personal information provided by the taxpayer; the fact that IR 137 did not contain any explicit warning that a failure to claim EIS would block the CGT exemption; and, finally, Mr Ames' record of careful compliance.

Robert Ames v HMRC TC4523

IHT and main residences (Lecture P910 – 30.09 minutes)

Ever since George Osborne, when he was Shadow Chancellor, announced that the Conservatives intended to raise the IHT nil rate band to £1,000,000, there has been speculation as to how this might be achieved. Now we know. The main details are set out in Cl 9 FB 2015, although further legislation is promised next year.

The first point to mention is that the standard nil rate band has been frozen at £325,000 for three more years, i.e. for 2018/19, 2019/20 and 2020/21 (Cl 10 FB 2015).

The increase referred to above is to come about through the introduction of an additional residence nil rate band when a home is passed on death to direct descendants of the deceased on or after 6 April 2017. The maximum amount of this new band will rise in stages to £175,000 in 2020/21 and any unused band will be transferable to a spouse or civil partner. There is also provision for a tapered withdrawal of the band for estates valued at more than £2,000,000. With this in mind, Cl 9 FB 2015 has inserted nine sections after S8C IHTA 1984. They are:

(i) S8D IHTA 1984 – extra nil rate band on death if interest in home goes to descendants;

(ii) Ss8E and 8F IHTA 1984 – calculation of residence nil rate amount;

(iii) Ss8G, 8H, 8J and 8K IHTA 1984 – meaning of various terms used in new legislation;

(iv) S8L IHTA 1984 – claims for transferable allowances; and

(v) S8M IHTA 1984 – cases involving conditional exemption.

New residence nil rate band

S8D(5) IHTA 1984 sets out the main parameters to be used in calculating the new residence nil rate band. It:

(i) states the maximum amounts of what the legislation calls the 'residential enhancement' for all years from 2017/18 onwards, ie:

- £100,000 for 2017/18;
- £125,000 for 2018/19;
- £150,000 for 2019/20; and
- £175,000 for 2020/21 and subsequent tax years;

(ii) confirms that, where the value of a person's estate (which takes its normal meaning of the assets less liabilities but before any reliefs and exemptions) is greater than a 'taper threshold' of £2,000,000, the residential enhancement will be withdrawn at the rate of £1 for every £2 by which the value of the estate exceeds the taper threshold; and

(iii) provides for the residential enhancement to be combined with any unused residence nil rate band transferred from a spouse or civil partner to give a total residence nil rate band (or 'default allowance').

The maximum amounts of the residence nil rate band and the taper threshold are to be index-linked to the CPI for 2021/22 onwards, rounded up to the nearest £1,000 (S8D(6) – (8) IHTA 1984).

Calculation of residence nil rate amount

S8E IHTA 1984 spells out the detailed rules for calculating both the amount of the residence nil rate band and the amount which can be transferred to a spouse or civil partner. These are the key points:

(i) The new regime only applies where a person's estate includes a qualifying residence and some or all of that property is left to one or more of the deceased's direct descendants, ie. it is 'closely inherited'. This term is widely defined – see S8K IHTA 1984 – and includes children, stepchildren, adopted children and foster children (plus their lineal descendants).

(ii) For estates valued at or below the taper threshold, where the value of the residence passing is less than the deceased's total residence nil rate band (ie. their default allowance), the amount of the residence nil rate band is limited to the value of that residence. Any unused excess is available for transfer to a spouse or civil partner. However, where the value of the property passing is greater than (or equal to) the default allowance, the amount of the residence nil rate band is the same as the default allowance. In this case, none of the residence nil rate band is available for transfer to a spouse or civil partner.

(iii) There are appropriate adjustments where the value of the estate is greater than the taper threshold (so that the taper mechanism comes into play).

Where an estate does not include a qualifying residence or where no part of such a property passes to direct descendants, the new regime is not in point. However, any unused residence nil rate band can still be transferred to a spouse or civil partner (S8F IHTA 1984).

Calculation of transferable residence nil rate band

S8G IHTA 1984 describes the rules for calculating the amount of any residence nil rate band which can be transferred to a person's estate from their deceased spouse or civil partner. Broadly speaking, the procedure follows the principles laid down in S8A IHTA 1984 for ordinary transferable nil rate bands, except that the amount transferred is based on a percentage of the residence nil rate band available to the *first* spouse or civil partner. If that person died before 6 April 2017, the figure of £100,000 is used.

No amount can be transferred unless a claim is made under S8L IHTA 1984 within two years from the end of the month in which the second spouse or civil partner died.

Qualifying residences

S8H IHTA 1984 defines what qualifies as a residence for the purpose of this legislation. The main condition is that the deceased must have had an interest in a property which was occupied as that person's residence when they owned it and which would have been part of their estate. If a person's estate includes only one such property, that property will be the qualifying residence. Where a person's estate includes more than one residence, it is up to the deceased's personal representatives to make an appropriate nomination. In this context, a residence includes land which is occupied and used as the property's garden or grounds. If the deceased lived in job-related accommodation and also owned a home which they intended to occupy in due course, that property can be treated as a qualifying residence.

The Government recognise that these new arrangements might act as an incentive for the older generation to remain in homes which are bigger than they really need. In order to counteract this, those who downsize or sell their homes on or after 8 July 2015 will effectively be able to 'bank' the additional nil rate band for use against the remaining value of their estate when they pass a smaller home or equivalent value assets to a direct descendant. Precise details will be subject to a consultation which is due to take place later this year. The relevant legislation will be included in FA 2016.

Illustration

David died on 1 October 2016 at the age of 73. He left his entire estate to his widow, Sandra. The estate was valued at £1,280,000 and included David's half-share of the couple's home. This half-share was worth £425,000.

Sandra died on 1 July 2018 and left everything to their two sons equally. Sandra's estate (including the assets which she inherited from David) was worth £2,050,000. The family home was valued at £980,000.

What is Sandra's IHT liability on the assumption that she had made no chargeable transfers in the seven years prior to her death?

David's transferable nil rate bands are:

	£
Standard nil rate band	325,000
Residence nil rate band	100,000
	£425,000

Because no part of David's nil rate bands had been utilised on his death, the relevant percentage is 100%. Thus Sandra's estate benefits from an additional nil rate band of 100% x £425,000 = £425,000.

Since Sandra's estate exceeds the taper threshold of £2,000,000, her adjusted allowance is reduced by one half of the excess, ie. by £25,000. Thus Sandra's nil rate band is:

	£	£
Standard nil rate band (x 2)		650,000
Residence nil rate band from David	100,000	
Residence nil rate band for Sandra	125,000	
	225,000	
Less: Excess	25,000	
		200,000
		£850,000

In other words, the IHT on Sandra's death estate is:

	£
On 0 – 850,000 = 850,000 @ 0%	–
On 850,000 – 2,050,000 = 1,200,000 @ 40%	480,000
	£480,000

Conclusion

While this relief will increase the number of homes which can be passed tax-free to the younger generation, the detail, particularly around the proposals for those who sell or downsize, adds considerable further complexity to the IHT code. Since, for many taxpayers, their most valuable asset will be their residence, one cannot help but wonder why the Chancellor has not chosen a more straightforward alternative by simply extending the nil rate band for *all* assets.

Contributed by Robert Jamieson

Entrepreneurs' relief and Lloyd's Names **(Lecture P908 – 6.31 minutes)**

In the recent case of *Carver v HMRC (2015)*, the First-Tier Tribunal held that a sale of syndicate capacity by a Lloyd's Name did not qualify for entrepreneurs' relief. As is well known, entrepreneurs' relief is available on the sale of all or part of a business and so the issue here was whether the sale by the Name of his syndicate capacity amounted to the sale of part of his business. HMRC are known to accept that gains on the final sale of a Name's capacity at Lloyd's attract entrepreneurs' relief.

The taxpayer claimed that the disposal of his capacity in a syndicate represented a disposal of 'part of a business' (see S169I(2)(a) TCGA 1992), given that it was a separately identifiable part of his underwriting business at Lloyd's. The taxpayer participated in 18 different syndicates. Furthermore, he contended that, since HMRC accept that the final sale of a Name's capacity at Lloyd's qualifies for entrepreneurs' relief, it must follow that the sale of any part before then also qualifies.

However, the Tribunal held that the trade carried on by the taxpayer was that of underwriting the risks assumed by the syndicate's managing agent. The capacity to participate in the syndicate's business was not itself the trade but rather a means by which the Name is enabled to carry it on (in conjunction with the other members of the syndicate). Capacity was an asset of the business but was not the trade or business itself.

Accordingly, the taxpayer was not entitled to make an entrepreneurs' relief claim on his sale and so the appeal failed.

Contributed by Robert Jamieson

Scrip dividends and discretionary trusts (Lecture P909 – 14.36 minutes)

The recent decision in *Seddon v HMRC (2015)* concerned a discretionary trust which had been established on 5 March 1999 by Mrs Seddon with five ordinary shares of £1 each in Seddon Seedfeeds Ltd (valued at £200,000).

On 30 January 2000, the trust received a scrip dividend of 187,500 preference shares of 1p each in the same company and, two days later, these were sold by the trustees for a consideration of £1,382,750, made up as follows:

(i) cash of £768,194; and

(ii) loan notes worth £614,556.

On 1 March 2009 (ie. four days before the trust's first 10-year anniversary charge), the trustees made a capital appointment of £1,260,361 to various discretionary beneficiaries.

The main issue which arose related to the calculation of the IHT on the exit charge. In order to resolve this problem, the First-Tier Tribunal had to answer three questions:

(i) Was the scrip dividend, as a matter of principle, income or capital in the hands of the trustees?

(ii) If the scrip dividend was capital, did it fall to be taken into account under S68(5)(c) IHTA 1984 for the purpose of calculating the tax on the exit charge?

(iii) If the scrip dividend was income, had the trustees accumulated that income as capital by the time of the distribution on 1 March 2009?

In broad terms, the position of the trustees was that the scrip dividend represented income in their hands (and had not subsequently been accumulated as capital by 1 March 2009). As such, it did not fall to be taken into account in calculating the tax on the exit charge. The rate of tax for the purpose of this exit was therefore 0% (the 'initial value' of the property originally settled being below the nil rate band on 1 March 2009) and so there was no IHT to be paid on the capital appointment.

HMRC, on the other hand, argued that the scrip dividend was capital in the hands of the trustees. Thus the 'initial value' of this addition *did* have to be included in the relevant IHT computation. They calculated a tax figure of around £55,000.

By virtue of Statement of Practice SP 8/86, HMRC accept that property which comprises trust income as a matter of general trust law is not caught by the discretionary trust charging provisions (ie. it is not relevant property), unless it is accumulated. SP 8/86 goes on to say:

> 'For the purpose of determining the rate of charge on accumulated income, the income should be treated as becoming a taxable asset of the trust on the date when the accumulation is made.'

Following the enactment of Para 4 Sch 25 FA 2014 which amends Ss64 and 66 IHTA 1984 in relation to 10-year anniversary charges falling on or after 6 April 2014, unaccumulated and undistributed trust income which arises more than five years before a 10-year anniversary is regarded as having been relevant property throughout the whole of the 10-year period leading up to that anniversary. However, this FA 2014 legislative change was not in point for the *Seddon* case.

Is a scrip dividend income or capital?

In contending that the scrip dividend shares were income for trust law purposes, the trustees relied on the High Court decision in *Pierce v Wood (2009)* which favoured this interpretation. In response, HMRC cited the more recent Upper Tribunal case of *Gilchrist v HMRC (2014)* which held that scrip dividend shares are capital in the hands of trustees. In both these cases, consideration was given to the Court of Appeal's ruling in *Howell v Trippier (2004)* to the effect that scrip dividend shares were income in the hands of the trustees of a discretionary trust for income tax purposes. Accordingly, the trustees of the Seddon Settlement were liable to income tax on the receipt of the scrip dividend at what in 1999/00 was known as 'the rate applicable to trusts'. However, the High Court judge in *Pierce v Wood (2009)* decided that *Howell v Trippier (2004)* was not just limited to the income tax treatment of scrip dividends – it was authority for a wider proposition that scrip dividends are income for the purposes of trust law generally. The Upper Tribunal judges in the *Gilchrist* case went the other way: *Howard v Trippier (2004)* was limited to the income tax treatment of scrip dividends and was not authority for any wider proposition in relation to trust law generally. They concluded that *Pierce v Wood (2009)* was wrongly decided.

This gave rise to an interesting discussion about the precedent status of the High Court and the Upper Tribunal respectively. It was explained that, as a matter of *stare decisis*, the Upper Tribunal is not bound by High Court decisions. In the end, the First-Tier Tribunal in *Seddon* judged that, where there was a conflict, they were bound to follow the more recent of the two first instance authorities. In other words, the *Gilchrist* outcome was preferred. Thus the scrip dividend and the proceeds therefrom represented capital in the hands of the trustees for IHT purposes.

Taken into account?

The value of the scrip dividend, when it was received by the trustees, was property comprised in the settlement. Under S68(5)(c) IHTA 1984, this value must therefore be included, along with the 'initial value' settled on 5 March 1999, as part of the hypothetical chargeable transfer envisaged by the IHT legislation.

Accumulation of income

Having determined that the scrip dividend constituted a capital addition to the trust, it was not strictly necessary for the First-Tier Tribunal to deal with the third question above. However, they decided that, because the onus was on the trustees to establish that the relevant income had not been accumulated (which they did not do), it had anyway become capital. As the First-Tier Tribunal put it:

'We cannot be satisfied that the scrip dividend remained part of the income of the settlement at the date of distribution.'

Conclusion

This outcome represents a significant victory for HMRC.

Contributed by Robert Jamieson

Abolition of bearer shares (Lecture P906 – 7.36 minutes)

With effect from 26 May 2015, S84 Small Business, Enterprise and Employment Act 2015 has abolished the concept of bearer shares for UK companies, following an amendment to S779 Companies Act 2006.

Bearer shares are unregistered and are able to be transferred by delivery. They are not – as some people have suggested – a means of putting the ownership of shares into a kind of limbo so that they do not belong to anyone. Bearer shares belong to the beneficial owner. The fact that they are unregistered and that ownership can therefore be transferred more easily does not affect their beneficial ownership – it just makes it more difficult for others to find out who the real owner is.

The general rule is that bearer shares are treated as situated in the territory where they are physically located. This means that they represent foreign property if they are kept abroad and so are excluded property for IHT purposes in the ownership of an individual who is not domiciled in the UK. A similar situs rule applied in the context of CGT so that foreign property could be created, subject only to the operation of the remittance basis if sold by a foreign-domiciled person. It may be remembered that this is what *Mehjoo v Harben Barker (2014)* was all about. However, this CGT treatment was changed by F(No2)A 2005 with the introduction of S275(1)(da) TCGA 1992 which caused bearer shares in a UK-incorporated company henceforth to be regarded as situated in the UK for all CGT purposes.

As a result of this year's legislation, it is no longer possible for a UK company to issue bearer shares. Furthermore, companies had 30 days in which to give notice to their bearer shareholders that they must surrender their bearer shares and have their holdings converted into registered shares. In addition, the company must spell out the consequences of not doing so. The company's notice had to be published in the London Gazette, put in a prominent place in the company's website (if there is one) or communicated to the bearer shareholders by the method customarily used by the company to contact them. Failure to follow this prescribed procedure is an offence on the part of the company.

Any bearer shares not surrendered and exchanged by 26 December 2015 can no longer be transferred and any purported transfer will be void. They will lose all their rights and any distribution to which the bearer shares would have been entitled must be paid into a separate bank account.

Companies which still have bearer shares on 26 February 2016 will be required to apply to the court to cancel them and, within 14 days of cancellation, to pay into court an amount equal to the nominal value of the shares together with any suspended distributions so as to ensure that all traces of the bearer shares are eliminated.

The abolition of bearer shares is aimed at promoting transparency of company ownership and control and is also intended to deter criminal misuse of companies in the UK. Because the holders of bearer shares are not necessarily known to the companies which have them in issue, they are often seen as an easy means of facilitating illicit activity such as tax evasion or money laundering

Bearer shares do still exist in companies based in some jurisdictions outside the UK. However, there are not many of these left, having regard to the present hostility towards anyone seeking confidentiality regarding their affairs.

Contributed by Robert Jamieson

Administration

Retrospective legislation lawful

Summary - The Court of Appeal found that retrospective legislation was lawful.

The appellants had implemented aggressive tax avoidance schemes designed to avoid SDLT. The question was whether retrospective legislation (amending FA 2003 s 45(1A)) targeting those schemes violated the European Convention on Human Rights (ECHR) Protocol 1 art 1 (A1P1) (protection of property) and art 6 (right to a fair trial).

The schemes had relied on sub-sale relief, which ensures that where successive transfers of rights relating to the purchase of a property (including options) are completed by a single property transfer, SDLT is chargeable only once on the property transfer. However, FA 2013 introduced an amendment, effective from 21 March 2012, that made it clear that the option arrangements entered into by the appellants had not constituted 'transfers of rights' and had therefore been subject to SDLT.

Decision:

The first question was whether the amendments had the effect of depriving the appellant of any possession that they had at the date of the legislative changes. The Court of Appeal observed that, by the time the amendments had been made, the money that the appellants might have used to pay the tax was already the subject of an unresolved argument with HMRC. The appellants had therefore been deprived of an argument that they were not liable to pay the tax, but not of the tax itself. A1P1 was therefore not engaged; and even if A1P1 had applied, the retrospective amendments would have been lawful.

The government had published a protocol *Tackling tax avoidance* (March 2011), which had warned about the possibility of retrospective legislation in 'exceptional circumstances' to avoid 'significant losses to the exchequer'. The Court of Appeal pointed to the 'serial abuse' of the relevant provisions and concluded that the retrospective changes had been foreseeable and therefore lawful. Furthermore, the balance between the general interests of the community and the protection of the individual's fundamental rights had fallen 'heavily on the side of the public interest', making the changes proportionate. Finally, applying the decision of the European Court of Human Rights in *Ferrazzini* [2001] STC 1314, the Court of Appeal held that the dispute was not civil, so that art 6 was not engaged.

Comments - Since the publication of the protocol in 2011, the government has used retrospective legislation on several occasions, often provoking the anger of taxpayers. This case confirms that retrospective tax legislation can be lawful. It is therefore likely that the government will continue to use this powerful tool when the need and justification arise.

On the refusal of cross-examination, Lord Justice Vos in the Court of Appeal said the judge's decision was “unimpeachable”. Cross-examination of the witnesses on the measures taken in relation to other stamp duty land tax schemes would be “wholly inappropriate”.

Lord Justice Vos concluded, “In this case, the balance between the general interests of the community and the protection of the individual's fundamental rights falls heavily on the side of the public interest.”

Finally, he said article 6 was not engaged, since tax disputes are not “civil” for its purposes. Regardless, he was “inclined to agree with the [High Court] judge that the legislative changes had satisfied the higher test of compelling grounds in the public interest”.

The Queen on the application of APVCO 19 and others v HMRC [2015] EWCA Civ 648

Joint application for reference to CJEU declined

Summary - The UT, refusing the joint application of the parties, declined to make a reference to the CJEU.

The taxpayer had appealed against HMRC's ruling that supplies for the construction of a conference hall were not zero rated because the building was not used solely for a relevant residential or charitable purpose within the meaning of VATA 1994, Sch 8 group 5 item 2. After the First-tier Tribunal dismissed its appeal, the taxpayer appealed to the Upper Tribunal.

The issue before the tribunal was whether “business” in note 6(a) had the same meaning as “economic activity” in the definition of “taxable person” in article 9 of the principal VAT directive.

The parties said that, in the context of the appeal, the concept of economic activity that underpinned the whole system of VAT was unclear. This was a joint application by Capernwray and HMRC, for an order that a reference be made to the CJEU for a preliminary ruling.

Decision:

The UT first noted that it was for the referring tribunal to determine whether it required the guidance of the CJEU. The fact that the parties were agreed that a reference should be made, whilst a factor that must be carefully considered, was not determinative of the need for a reference. Under TFEU art 267, a question should be referred to the CJEU only if a decision was necessary in order that the referring tribunal could give judgment. The UT therefore considered that for a reference to be made, it needed to be satisfied that a tribunal would not be able to resolve the relevant issues with complete confidence. Having reviewed each of the relevant issues, as well as the body of European jurisprudence relating to them, it concluded that that 'it was more likely than not' that the tribunal hearing the substantive appeal would be able with complete confidence to decide the answers.

Comments - Even though both parties agreed that a reference to the CJEU was necessary, the UT turned down their application on the basis that there was a sufficient body of CJEU case law for a tribunal to decide the issues with confidence.

Capernwray Missionary Fellowship of Torchbearers v HMRC [2015] UKUT 368

Estimated assessment

Summary – The Tribunal found that an assessment was correct even though it appeared to be mis-numbered

Ms B had admitted to inflating claims to repayment of input tax in her quarterly returns as well as forging invoices. She had been charged and had pleaded guilty to the offence of cheating the public revenue. She contended that some of the assessed tax was input tax to which she was properly entitled as incurred on purchases actually made in the course of her business.

Decision:

The First-tier Tribunal noted that an assessment is correct save to the extent that the taxpayer can quantify it to be wrong. Whilst it was accepted that there was some genuine input tax, Ms B had admitted that she did not keep her business receipts so that her genuine input tax could not be quantified. Therefore, the assessment was correct and enforceable.

The assessment for the periods 7/05 to and including 01/09 was referred to on the Notice of Assessments as being for period "00/00" as HMRC's computer system did not permit period by period assessments for periods more than 4 years ago. The First-tier Tribunal held that the assessment was valid as it contained; the taxpayer's name, the amount of tax due, the reason for the assessment, and the period of time to which it related.

Finally, the assessments were not out of time. *VATA 1994, s 73(6)* required HMRC to issue the assessments within one year of obtaining evidence of the relevant facts and the First-tier Tribunal was satisfied that HMRC had not received the bank records more than one year before the date of the assessment. Those bank records were essential as they showed no payments to 'would-be suppliers'. The First-tier Tribunal confirmed the correctness and the validity of assessments and upheld penalties imposed for deliberately inflating claims to repayment of tax.

Comments – The taxpayer had an ill founded argument regarding the assessment. Despite the incorrect details all other elements were correct.

Monica Bircham v HMRC (2015) TC04486

Confiscation orders and discovery assessments

Summary - The UT found that the issue of a confiscation order did not preclude HMRC from raising a discovery assessment.

Mr Martin had been convicted in relation to his involvement in the sale of counterfeit/contraband cigarettes. The prosecution had applied for a confiscation order under the Proceeds of Crime Act 2002. HMRC raised discovery assessments on a protective basis. The assessments were made on the basis of what HMRC believed to have been Mr Martin's profits in order to build, furnish and maintain a house and to maintain his lifestyle. Mr Martin's case was that the amount of the confiscation order included any liability to tax.

Decision:

The UT first observed that the Crown Court had not decided that the house had been constructed before the earliest of the assessment periods, so that there was no decision precluding HMRC from raising the assessments. Furthermore, even if the Crown Court had decided that the house had been built before the relevant assessment periods, HMRC would not have been precluded from raising assessments. This is because the confiscation order was not final; because government departments were not expected to liaise with each other; and because Mr Martin's failure to pay his tax was not a criminal offence, so that it was not part of the general criminal conduct which the Crown Court would have taken into account. HMRC should not be concerned, when assessing the tax, with whether income was derived from criminal activities.

Finally, the UT observed that the purpose of TMA 1970 s 29 was to ensure that a taxpayer paid the proper amount of tax, whereas the purpose of a criminal lifestyle confiscation order was to ensure that a person with a criminal lifestyle was prevented from retaining the benefit of his criminal conduct.

Comments - Mr Martin's tactical error was that he had failed to provide any evidence contradicting the 'best judgment' assessments made by HMRC. His appeal was therefore doomed to failure but for his confiscation order argument, which was roundly rejected.

John Martin v HMRC [2015] UKUT 161

Helpline failure – reasonable excuse

Summary – The taxpayer had a reasonable excuse as the Tribunal recognised that the taxpayer had sought guidance from HMRC

A small brickwork contractor engaged its own subcontractors until 2010 and had operated the construction industry scheme for many years. From 2010, it used an agency, LDCL, to obtain workers. The agency had gross payment status, as a result of which the taxpayer did not need to deduct tax.

When the taxpayer's bookkeeper left in 2011, the person who took over had no experience of the work. She continued to make nil CIS300 returns on the basis the previous bookkeeper had believed that payments to LDCL need not be reported.

At a routine check, HMRC told the company that the amounts should be included, even if they were paid gross to an agency. They imposed penalties.

The company appealed, saying that the error appeared to have arisen as a result of a call between the former bookkeeper and HMRC's helpline. HMRC said there was no evidence to show the bookkeeper had contacted the helpline for advice.

Decision:

The First-tier Tribunal said it was clear that the previous bookkeeper had believed the payments did not need to reported, and this explained why the mistake continued after she left.

Contrary to HMRC's contention that there was no evidence of the bookkeeper contacting the helpline, the tribunal said there was evidence to show the former bookkeeper, the company director and the new bookkeeper had called it several times and received unclear advice.

Further, as the Revenue said, a lot of guidance on the construction industry scheme was available on HMRC's website and in their publications, but the tribunal said it could not be "reasonably assumed that a taxpayer will have read all of it".

The judge said the taxpayer had "a responsible attitude to its duties as a taxpayer and did its best to, and thought it had, fully complied with its obligations in relation to its … CIS300 returns". It had a reasonable excuse and the penalties were set aside.

The taxpayer's appeal was allowed.

Comments – This is another case which demonstrated the importance of evidence in a taxpayer's attempt to do the right thing and it was clear to the Tribunal that the taxpayer had contacted HMRC despite the HMRC stating there had been no such communication.

Barking Brickwork Contractors Ltd v HMRC TC4454

Judicial proceedings and tax appeals

Summary - The Court of Appeal rejected an application to stay proceedings.

The issue was whether there should be a stay of judicial review (JR) proceedings, designed to establish whether the respondents had a legitimate expectation of being entitled to a repayment of tax, while proceedings to determine whether they were liable for the tax were heard and determined.

Decision:

The Court of Appeal rejected HMRC's appeal for a stay on the basis that HMRC had not clarified its case in relation to the JR proceedings, so that the court could not ascertain the amount of overlap (if any) between the two proceedings.

Comments - In *Gaines-Cooper* [2011] 1 WLR 2625, the appeal had been stayed to allow the JR proceedings to run their course; however, in this case, the Court of Appeal rejected HMRC's application for a stay. It also noted that the lack of resources available to HMRC could not justify its failure to get its case in order.

FCC Environment UK and others v HMRC [2015] EWCA Civ 747

How income tax revenue will change in Scotland

From April 2016 the main UK rates of income tax will be reduced by 10p for Scottish taxpayers and in its place the Scottish Parliament will be able to levy a Scottish Rate of Income Tax (SRIT) applied equally to all Scottish taxpayers. If the SRIT is set at 10p then income tax rates will be the same as in the rest of the UK. SRIT can be reduced to zero and there is no upper limit.

Increasing the SRIT, for example from 10p to 12p, will result in a larger percentage increase in income tax liabilities for lower earners compared to higher earners.

Lowering the SRIT, for example from 10p to 8p, will result in a larger percentage decrease in income tax liabilities for lower earners compared to higher earners

Additional rate taxpayers (around 14,000 in 2013-14), make up half a percent of the taxpayer population in Scotland. Nearly one in seven additional rate taxpayers in Scotland are employed in health and social work, more than in Scotland's finance and insurance sector.

Additional rate taxpayers react the most to changes in tax rates. They also account for a disproportionately large share of income tax liabilities. Possible ways additional rate taxpayers might respond to changes in SRIT include:

- Time – Delaying or pulling forward
- Form – Receiving dividends instead of salary, increasing pension contributions etc
- Location - paper or physical migration

Deadline dates for August 2015

1 August 2015

- Corporation tax liabilities due for periods ended 31 October 2014 if not liable to instalments.
- Outstanding 2013/14 self-assessment tax returns now subject to a penalty of £300 or 5% of tax due whichever is higher (in addition to previous late filing penalties).

2 August 2015

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

5 August 2015

- First quarterly report by employment intermediaries for period 6 April to 5 July 2015.

7 August 2015

- Due date for VAT return and payment for 30 June 2015 quarter (electronic payment).

14 August 2015

- Quarterly corporation tax instalment payment for large companies.
- Monthly EC sales list if paper returns used.

19 August 2015

- Pay PAYE/CIS for month ended 5 August 2015 if by cheque.
- File monthly CIS return.

21 August 2015

- Online monthly EC sales list.
- Intrastat —supplementary declarations for July 2014.

22 August 2015

- PAYE/NIC/student loan payments if being paid online.

31 August 2015

- Companies House: filing of accounts for private companies with 30 November 2014 year end.
- Companies House: filing of accounts of public limited companies with 28 February 2015 year end.
- CTSA returns for accounting periods ended 31 August 2014.
- Annual adjustment for VAT partial exemption claims May year end if not already adjusted.
- Submit PAYE settlement agreement figures to HMRC to enable final income tax and National Insurance liabilities to be advised for 19 October 2015.

HMRC News

Employment intermediaries

From 6 April 2015, employment agencies must return details of all workers they place with clients where no PAYE system is use for workers' payments. The return is a report that must be sent to HMRC once every 3 months, using HMRC's report template, and is a requirement for all employment intermediaries. In recent years HMRC has seen increasing evidence of growth by some employment agencies helping to create false self-employment and supplying UK workers from an offshore location. Both of these methods have been used to reduce employment taxes and avoid having to fulfil their legal employment rights and obligations. The Income Tax (Pay As You Earn) (Amendment No. 2) Regulations 2015 give HMRC information that enables it to decrease false self-employment and abuse of offshore working.

Separately, HMRC is consulting until 30 September 2015 on proposals to remove tax relief for home-to-work travel and subsistence where a worker is employed through an employment intermediary and under the supervision, direction or control of any person. This consultation seeks views on the detail of how these proposals would work and how they can best be implemented. This follows the original consultation which ran from December 2014 to February 2015 and revises some of the original proposals aimed narrowly at umbrella companies. A response document will be published later this year and any consequential legislative changes will be announced at Autumn Statement 2015. Final legislation will be included in Finance Bill 2016, for implementation from 6 April 2016.

Employee benefits and expenses

HMRC is consulting until 2 December 2015 on four sets of regulations required to: abolish the £8,500 threshold for benefits in kind; allow employers voluntarily to 'payroll' specified benefits in kind; replace dispensations with an exemption for specified business expenses; and remove the requirement for employers to report these expenses on form P11D. The changes would take effect from 6 April 2016.

Capital allowances regulations

The Capital Allowances (Energy-saving Plant and Machinery) (Amendment) Order, SI 2015/1508, gives statutory force to lists specifying energy-saving technologies and products which qualify for 100% first year plant and machinery capital allowances.

The Capital Allowances (Environmentally Beneficial Plant and Machinery) (Amendment) Order, SI 2015/1509, specifies water-efficient technologies and products which qualify for 100% first year plant and machinery capital allowances

Deeds of variation

HMRC has called for evidence into the use of deeds of variation (DoV) for tax purposes. This follows the recent Budget announcement that the government is reviewing the use of DoVs for tax purposes to ensure that they are not being abused. The deadline for receiving responses is 7 October 2015. The government is also willing to meet interested groups as part of this call for evidence process (email ihtandtrustsconsult.car@hmrc.gsi.gov.uk).

Non-dom IHT changes

The government intends to legislate in Finance Bill 2016 to bring forward the point at which individuals are treated as deemed domiciled in the UK for IHT purposes to include where they have been resident in the UK for more than 15 out of the past 20 tax years, with effect from April 2017. A detailed consultation document will be published after the summer recess.

On broader changes to the taxation of non-domiciles, the government intends to legislate in Finance Bill 2017, with effect from April 2017, to ensure that IHT is payable on all UK residential property owned by non-domiciles, regardless of their residence status for tax purposes, including property held indirectly through an offshore structure. A full consultation will follow later this year.

Sporting testimonial income

HMRC is consulting until 2 September 2015 on options for legislating the tax and NICs treatment of income from sporting testimonials, to replace the existing extra-statutory concession which is due to be withdrawn after 5 April 2016.

Pensions relief reform consultation

The government is consulting until 30 September 2015 on whether there is a case for reforming the current system of pensions tax relief.

Class 3A NIC regulations

The Pensions Act 2014 (Commencement No. 5) Order, SI 2015/1475 includes provisions for the class 3A voluntary NICs/state pension top-up scheme to come fully into force on 12 October 2015, allowing eligible individuals to pay a class 3A contribution in return for a unit of additional state pension.

Farmers' averaging profits period

HMRC is consulting until 7 September 2015 on the detail of its proposal to extend the averaging period for farmers' profits from two years to five years with effect from April 2016, with a view to legislating in Finance Bill 2016.

National Insurance Contributions (Rate Ceilings) Bill

The National Insurance Contributions (Rate Ceilings) Bill provides that, for the duration of this Parliament, the rate of Class 1, Class 1A and Class 1B National Insurance contributions (”NICs”) paid by employees, employers and third parties will not exceed the current rates and the Upper Earnings Limit (”UEL”) should not exceed the Higher Rate Threshold for income tax.

Government confirms Tax-Free Childcare launch date as it welcomes judgment from Supreme Court

The government (on Wednesday 1 July) welcomed a judgment from the Supreme Court that found the government’s proposals for delivering Tax-Free Childcare to be clearly lawful.

It also confirmed that, as a direct result of the legal challenge, the scheme is now expected to launch from early 2017. The existing Employer-Supported Childcare scheme will remain open to new entrants until Tax-Free Childcare is launched.

As a result of the legal action, the court placed a suspension on the development of the scheme which prevented key delivery steps from taking place. This legal action was brought by a small group of childcare voucher providers involved in the delivery of the scheme that Tax-Free Childcare will eventually replace.

Exchequer Secretary to the Treasury, Damian Hinds said:

We are pleased that the government's proposals for delivering Tax-Free Childcare have been found to be clearly lawful. This government is absolutely clear on the importance of supporting families with their childcare costs.

It is disappointing that some organisations involved in the existing scheme felt the need to take and persist in this costly and wasteful course of action, which has led to a delay in the launch of Tax-Free Childcare.

We are now pressing ahead with the scheme as part of our ongoing commitment to support working families.

Tax-Free Childcare is part of the government's long-term plan to support working families and will provide up to 1.8 million families across the UK with up to £2,000 of childcare support per year, per child, via a new simple online system.

The government is clear on the importance of supporting families with their childcare costs. Spending on childcare was increased by £1 billion in the last Parliament and the government has also committed to doubling free childcare for working parents of three and four year olds to 30 hours a week.

Offshore tax evaders and the professionals who enable tax evasion will face even tougher sanctions.

The new regime to crack down on offshore evaders, which HM Revenue and Customs (HMRC) will consult on, includes:

- a new criminal offence for offshore evasion – so in the worst cases it's no longer possible to plead ignorance in an attempt to avoid criminal prosecution
- a new criminal offence for corporates who fail to prevent tax evasion or the facilitation of tax evasion on their watch
- increasing the financial penalties faced by evaders – including, for the first time, linking a penalty to the value of the asset hidden offshore
- new civil penalties on those who facilitate evasion so they will face the same penalty as the tax evader
- publicly naming both evaders and those who enable evasion

Speaking at HMRC's Stakeholder Conference in London, Financial Secretary to the Treasury, David Gauke, said:

> Time's up for people who don't pay their fair share of tax by hiding their money offshore. People who evade tax, facilitate or turn a blind eye to tax evasion will now face powerful criminal and civil sanctions under our tough new regime.
>
> We've already seen over 90 countries across the world sign up to automatically exchange information on taxpayers. This, together with our new sanctions, will mean there is nowhere left to hide for offshore tax evaders.
>
> In the last few years there has been huge progress in tackling offshore tax evasion. HMRC has already collected over £2 billion from previously undisclosed offshore income through agreements with Switzerland, Liechtenstein and the Channel Islands. As announced in the March 2015 Budget, these offshore disclosure agreements will close early (31 December 2015) and be replaced by a tougher last chance facility ahead of the automatic exchange of tax information with over 90 countries, including tax havens, from 2017.

Business Taxation

Losses update (Lecture P907 – 8.56 minutes)

Unrelieved losses carried forward

Unrelieved trading losses can only be carried forward and set against profits from the same trade so, when looking to turn a business around, care must be taken as to the types of changes that are made.

In a recent case, HL Amah v HMRC, a loss making franchisee-dispensing optician became a self-employed locum. Loss relief was denied on the grounds that the trade was not the same. Key factors in this decision were:

- that the franchisee operation was a trade while acting as a locum was a profession,
- the franchisee has a premises whilst the locum does not, and
- the franchisee is answerable to their customers whilst locums are answerable to the optician that they are working for.

When carrying losses forward, never prepare separate accounts as that is a clear indication that you do not consider your activities to be the same trade.

As a tax adviser it is important to review your client's activities each year to determine whether a change in the nature of trade has occurred. Carrying losses forward in error can result in a penalty.

Sideways loss relief

No claim for losses under "sideways" relief is possible for the self-employed unless the trade is being carried on on a commercial basis with a view to profit.

In the case of Richard Murray v HMRC, Mr Murray claimed losses in relation to a race horse breeding and trading business, which totalled about £130,000 over a three-year period. Loss relief was denied as his activity was held to be a hobby and not a business.

Never combine trades

In the recent case of J. Thorne the taxpayer set up an equestrian business with two horses. Four years later she began a new trade of asparagus farming which she anticipated would return substantial profits after the third harvest.

She claimed sideways loss relief in respect of her equestrian and asparagus farming business but relief was denied by HMRC on the grounds that the equestrian business was not run on a commercial business.

The First Tier Tribunal said that the loss making asparagus trade was run on a professional basis, but the two ventures had to be considered as a composite whole because the claim had been made in respect of both trades.

On this basis the trade could not be viewed as commercial because it included the uncommercial equestrian element. If the two activities had been accounted for separately, then the losses relating to the asparagus business should have been available for sideways relief.

Trading or investment?

In *Terrace Hill (Berkeley) Ltd v HMRC (2015)* the company was involved in the development and sale of a prestigious office property. The key question was whether the loss on disposal represented a trading or capital loss.

The First Tier Tribunal held that it was capital on the grounds that:

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

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

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

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

(v) The sale in 2005 was motivated by a disappointing initial rental performance but it was the extremely attractive price offered which made the sale a virtual no-brainer.

Disallowable business expenditure **(Lecture B907 – 9.43 minutes)**

In *Healy v HMRC (2015)*, the actor Tim Healy, probably best known for playing Dennis Patterson in the long-running TV series 'Auf Wiedersehen, Pet', lost a claim for tax relief on a three-bedroom flat which he rented in central London while working away from home.

Healy, who lives in Cheshire, was cast in the West End musical 'Billy Elliott' for nine months during the tax year 2005/06. He decided to rent a flat near the theatre for this period. The weekly cost of renting the flat (£875) was comparable to that of staying in a hotel or similar accommodation, but it also allowed him extra room – compared to a hotel – for practice and coaching. Healy never intended to make London his home. He therefore claimed the cost of the rental against his income for 2005/06 as an allowable expense.

However, HMRC disallowed this claim on the basis that the long rental term represented a private living cost rather than a cost of doing business. Healy appealed to the First-Tier Tribunal in March 2012 where he was successful.

The Tribunal agreed that he had not moved house and so his expenses were wholly and exclusively work-related in accordance with S34(1)(a) ITTOIA 2005. Accordingly, he was granted relief for all his accommodation costs. Indeed, the Tribunal made a finding of fact using the following words… 'I do not find there was a duality of purpose.'

HMRC in turn appealed to the Upper Tribunal which, in July 2013, ruled that the lower court had applied the wrong test. The case was sent back to the First-Tier Tribunal for reconsideration, with the instruction that Healy's intentions at the time of entering into the tenancy agreement should be examined.

The First-Tier Tribunal released its second *Healy* judgment on 28 May 2015. On this occasion, the Tribunal took special account of the fact that Healy admitted in his evidence that part of the reason for renting a three-bedroom flat was that he wanted space for guests. This, stated the Tribunal, meant that the flat rental was not wholly and exclusively incurred for the purpose of Healy's business. The fact that the flat cost no more than a hotel was irrelevant to this duality of purpose. Nor could the non-business use of the flat be apportioned. It thus ruled against the actor and disallowed his claim.

Despite being unfavourable in this instance, the decision leaves room for similar claims to succeed in cases where such an admission has not been made. This is especially true in the light of the Upper Tribunal's comment in *HMRC v Healy (2013)* that there is no reason why expenditure on rental accommodation is in a different position to hotel or club accommodation, 'except in special cases'.

'Although a disappointment for the taxpayer, this case is highly significant for self-employed taxpayers who go away on business' was the understated summary of Healy's tax counsel. Many practitioners will find the decision hard to understand.

Contributed by Robert Jamieson

Annual investment allowances (AIAs) going forward **(Lecture B906 – 8.49 minutes)**

Since April 2008, most businesses (regardless of size) have been able to claim a 100% AIA on all their plant or machinery expenditure – other than on cars – up to a specified annual maximum.

At present, the limit stands at £500,000, but it was due to fall back to only £25,000 on 1 January 2016 (see S10 and Sch 2 FA 2014). The temporary increase to £500,000 was designed to stimulate growth in the economy by providing an additional time-limited incentive for businesses – particularly small and medium-sized ones – to increase or bring forward their capital expenditure on plant or machinery.

However, in his Budget Speech on 18 March 2015, the Chancellor announced the Government's commitment to set the 2016 limit at a more realistic level. Accordingly, Cl 8 FB 2015 has increased to £200,000, for expenditure incurred on or after 1 January 2016, the maximum AIA which can be claimed for a 12-month chargeable period. This limit is to apply for the foreseeable future.

For companies and unincorporated businesses with a 31 December year end, the new regime should cause no particular problem: the AIA limit for 2015 expenditure will remain at £500,000, reducing to £200,000 for expenditure incurred in 2016. But, for companies and unincorporated businesses with any other accounting date, the transitional rules set out in Para 4 Sch 2 FA 2014 are in point. These treat the actual chargeable period as two separate chargeable periods, one ending on 31 December 2015 and the other commencing on 1 January 2016. The maximum AIA entitlement is then the sum of the two parts.

Illustration

Mervyn Property Development Ltd has an accounting date of 31 March. For the chargeable period from 1 April 2015 to 31 March 2016, the company's AIA limit for this period is based on:

(i) the proportion of the period from 1 April 2015 to 31 December 2015, ie. 9/12 x £500,000 = £375,000; and
(ii) the proportion of the period from 1 January 2016 to 31 March 2016, ie. 3/12 x £200,000 = £50,000.

This produces a maximum of £425,000. In other words, if Mervyn Property Development Ltd has only incurred £310,000 on qualifying plant or machinery in that 12-month period, full relief will be due.

Unfortunately, there is one rather unnecessary trap: the legislation provides a restriction for the period which commences on 1 January 2016 such that, for expenditure incurred in that second period, no claim can be made for more than the maximum limit for the period.

Thus, if the company in the above illustration had incurred capital expenditure for the year ended 31 March 2016 as follows:

Date of qualifying expenditure	**Amount**
1 August 2015	£240,000
1 March 2016	£70,000

its AIA entitlement would be cut back to £240,000 + £50,000 = £290,000. The remaining unrelieved balance of £20,000 would only be eligible for writing down allowances. Notice that this rule does *not* apply in reverse.

Contributed by Robert Jamieson

No more tax relief for goodwill amortisation (Lecture B909 – 8.33 minutes)

Under Ss711 – 906 CTA 2009, companies have been able to obtain corporation tax relief when expenditure on goodwill and other intangible assets is recognised in the accounts. This relief is available to companies acquiring a business through a direct purchase of a trade and assets. It also applies to self-created goodwill. It has never been in point for companies acquiring shares in other companies (ie. where the goodwill arises on consolidation).

Cl 32 FB 2015 provides that relief will no longer be available for the amortisation of goodwill and customer-related intangible assets acquired or created by a company on or after 8 July 2015. Furthermore, any debits arising on the realisation of such assets will henceforth be treated as non-trading items. The practical effect of these changes is that there will now be limited ways in which such debits can be utilised (other than in the year of the asset's realisation).

The definition of goodwill and customer-related intangible assets is widely drafted. They are referred to in new S816A CTA 2009 as 'relevant assets' and include:

(i) goodwill;
(ii) information which relates to customers or potential customers of a business;
(iii) the relationship (whether contractual or not) which the business owner has with his customers;
(iv) an unregistered trademark; and
(v) a licence or other right in respect of any of the above assets.

This mirrors the 'incorporation' definition introduced in S849B(2) CTA 2009 by S26 FA 2015 in connection with transfers of goodwill to a company by a related individual or firm. The FA 2015 provision has now been superseded.

The changes do not apply in cases where a relevant asset is acquired before 8 July 2015. However, there is no such let-out for relevant assets created prior to 8 July 2015.

The rationale for Cl 32 FB 2015 is explained as follows by HM Treasury:

> 'This clause removes this relief with regard to the purchase of goodwill and other intangible assets closely related to goodwill. It will restrict the ability of companies to reduce their corporation tax profits following a merger or acquisition and removes this artificial incentive to buy assets rather than shares.'

Note that this new measure does not impose any restriction in respect of intangible assets apart from goodwill and other specified 'relevant assets'. Investment expenditure on intellectual property and other intangible assets will continue to qualify for relief under CTA 2009.

Contributed by Robert Jamieson

Claims for ACT credits were time-barred

Summary - The Court of Appeal found that the trustees' claims for tax credits were time-barred.

The trustees were appealing HMRC's decision to disallow claims for the payment of tax credits related to dividends received by the BT Pension Scheme (an exempt approved scheme). These had been calculated by reference to the advance corporation tax (ACT) paid by UK distributing companies.

Under the ACT regime (abolished with effect from 6 April 1999), as pension schemes had virtually no taxable income (against which tax credits could be set off), credits gave rise to payments by HMRC. However, the receipt of foreign income dividends (FIDs) (dividends paid by a UK company in relation to income received by it from its subsidiaries) did not entitle the recipient to a tax credit. The recipient was instead deemed to have borne tax at the lower rate; therefore, exempt recipients did not get any relief.

The denial of tax credits in relation to FIDs had been found to be in conflict with EU law principles in *Manninen* (C-319/02) and *Test Claimants in the FII Group Litigation* (C-446/04) (*FII (GLO)*).

Decision:

The court observed that it did not follow from the fact that a piece of domestic legislation infringed the EU rights and freedoms of one person or class of persons, that another person or class of persons may automatically claim relief. Claimants must show that their own EU rights had been infringed. This was not clear in the case of the trustees. Furthermore, it was not established that the trustees, as shareholders, could rely upon an infringement of the paying company's EU rights, because they were adversely affected by the infringing provision of domestic tax law (the 'piggyback' argument).

The Court of Appeal found that the issue relating to the 1997/98 dividends must be referred to the CJEU; however, it found that the claims relating to the other years were time-barred. The principle of effectiveness did not require a suspension of the time limits in circumstances where tax had been collected on the basis of an understanding of the law which had subsequently been judicially found to be wrong. However, were it not for the finding in relation to limitation, those claims would have also been appropriate for a reference.

Comments - This latest development in a very long judicial saga does not conclude the issue, since the 1997/98 claims will be referred to the CJEU. Perhaps more importantly, the Court of Appeal rejected the notions that the CJEU decisions had given the trustees an automatic claim; or that they could 'piggyback' on the rights of the paying companies.

The Trustees of the BT Pension Scheme v HMRC [2015] EWCA Civ 173

Capital allowances schemes failed

FTT found that schemes designed to enhance capital allowances and interest relief did not work.

The schemes broadly worked as follows (using hypothetical simple numbers). The partnership paid 100 to a special purpose vehicle (SPV) to undertake research work. The 100 was verified by a third party as the amount required to undertake the research conventionally. The SPV then subcontracted the work to a company which held the technology, expertise, systems and databank to enable it to perform the work for a fraction of the price. The SPV therefore only paid 6 to its subcontractor. As the partnership had paid 100 to the SPV, it hoped to claim capital allowances for 100. The scheme was then revised following changes in the legislation.

Decision:

A clause of the contract between the partnership and the SPV provided that the SPV 'shall by itself or through the appointed subcontractor undertake for the partnership a programme of research work'. The FTT observed that there was no intention that the SPV would or could undertake the project itself, so that the first limb of the clause was false; and it was the foundation of the partnership's claim for vastly excessive capital allowances. The transaction must therefore be struck down as a sham. Furthermore, applying CA 2001 s 437 purposively, and analysing the facts realistically, it was 'absolutely impossible' to conclude that capital expenditure has been incurred on any scientific research in any amount in excess of six.

Additionally, all the money movements were steps in a scheme designed to generate upfront tax savings, so that no trading activity took place. This meant that monies borrowed from banks were not 'used wholly for the purposes of the trade' conducted by the partnership, so that interest relief was not available under ICTA 1988 s 362. Finally, interest relief must, in any event, be denied under ICTA 1988 s 787.

Comments - The schemes seemed doomed. Not only were they found to be shams, but they also fell foul of several legislative provisions.

The Brain Disorders Research Limited Partnership v HMRC [2015] UKFTT 325

Oil and gas company: gains subject to the supplementary charge

Summary - The UT found that a gain realised by an oil and gas company on the disposal of a North Sea interest was subject to the supplementary charge.

Wintershall's activity was the development and production of oil and gas. It had realised a gain of over £6m on the disposal of an interest in the North Sea. The gain was part of Wintershall's 'ring fence profits' and the issue was whether it was also part of its 'adjusted ring fence profits' subject to a supplementary charge under ICTA 1988 s 501A(1).

Decision:

Adopting a purposive interpretation of the provisions, the UT noted, in particular, that for corporation tax purposes, the word 'profits' means 'income and chargeable gains' (ICTA 1988 s 6(4)(a)). Where the words used had such a clear and well established meaning, it was to be assumed, unless the contrary was shown, that Parliament must have used them in that sense. The aggregate chargeable gain arising from the disposal therefore fell to be included in Wintershall's calculation of its liability to the supplementary charge.

Comments - The case law on the calculation of the supplementary charge applying to ring fenced trades in the oil and gas industry is extremely limited. This case may therefore provide some very useful guidance.

Wintershall (E&P) v HMRC [2015] UKUT 334

VAT

Flawed record

Summary – The Tribunal enforced the penalty for careless behaviour justifiably

The taxpayer, a second-hand car dealer, made errors in his VAT returns for three successive VAT quarters in 2012 resulting in a net underpayment of tax of more than £150,000. HMRC discovered the mistakes during a compliance visit and imposed a 15% penalty for careless behaviour.

The taxpayer appealed, saying the penalty should be suspended.

HMRC refused on the ground that similar errors had occurred in 2010 and the penalty then had been suspended. A condition of that suspension was that the company should check its output tax figures before submitting its VAT returns.

Decision:

The First-tier Tribunal agreed that the inaccuracies were careless, but said its jurisdiction on the penalty was confined to determining whether HMRC's refusal to suspend it was "flawed". It could consider only the way the decision was reached rather than the merits of the decision.

The judge concluded that the taxpayer's compliance history was poor and therefore HMRC's decision not to suspend the penalty was justified.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, said: "Before submitting any return to HMRC, the taxpayer and adviser should ask: do the figures look sensible for the trading period in question? If the answer is 'no', further analysis is needed. As the saying goes, if something seems too good to be true, it usually is."

Automotion CPM Group Ltd v HMRC TC4380

TOGCs and VAT groups

Summary -The UT found that the transfer of a business to a company which was part of a group, and which was to make supplies internal to the group, could qualify as a TOGC.

The appeal related to HMRC's decision that the transfer of Intelligent's (IMS's) banking support services business to Virgin Money (VM), a member of Virgin Money Group (VMG) VAT group, was not a 'transfer of a going concern' (TOGC).

Because VMG was a VAT group, it was treated as carrying on the VM business as part of its overall business of the provision of retail banking services, so that the banking engine services provided internally by VM to the group were incorporated into the broader retail banking services supplied by VMG to its customers.

The question was whether this fiction, created by the VAT group rules, meant that VMG was not to be treated as using the assets transferred in carrying on the same kind of business as IMS.

Decision:

The UT noted that it was necessary to have regard to all the circumstances in determining whether the transaction had been a mere transfer of assets, or a transfer of an undertaking which could carry on an independent economic activity. The UT held that the activities of VM contributed directly to the economic activity of the group as a whole; and that it would be wrong in principle to seek to identify the nature of the group's activity as a whole by reference solely to the external supplies it made. The fiction of the VAT group did not extend to treating the group as carrying on a different, amalgamated business, in which the separate businesses of the group lost their individual identity.

Comments - The FTT had found that there could not be a TOGC where the transferee was to be part of a VAT group and was to only make supplies to members of that group. The UT has now confirmed that the VAT fiction of a business carried out by a group does not extend to ignoring the fact that each group company carries on a separate business. It remains to be seen whether the decision will be appealed.

Intelligent Managed Services v HMRC [2015] UKUT 341

Gaming machines and the 'element of chance'

Summary - The Supreme Court found that the takings from gaming machines connected to an external 'random number generator' (RNG) were subject to VAT.

The gaming machines in issue were connected to a RNG which could serve up to six terminals. Under the VAT (Betting, Gaming and Lotteries) Order, SI 1975/3328, the takings from a gaming machine are not exempt if the 'element of chance in the game is provided by means of the machine'. The issue was whether the 'element of chance' in a game played on these gaming machines was 'provided by means of the machines'.

Decision:

The Supreme Court referred to the definition of 'machine' in the *Concise Oxford English Dictionary*: 'an apparatus using or applying mechanical power, having several parts, each with a definite function and together performing certain kinds of work'. The court stressed that the overall purpose of the apparatus was to enable the playing of a game of chance in which both the machines and the RNG played essential and connected functions. Even where the RNG was serving several terminals, it seemed no less appropriate to treat the combined set of apparatus as a composite 'machine', at least where (as was the case here) the combination had been designed and supplied for use together in the same premises, and the RNG functioned for all material purposes in exactly the same way as embedded software in each terminal.

Furthermore, the element of chance in any game was provided 'by means of' the action of the particular player in pressing the button and so interrupting that ever-changing sequence at a particular moment. The terminal was not simply communicating information from the RNG, but was the active means by which the winning or losing combination was generated, the RNG's response being automatic. The element of chance was therefore provided 'by means of' the terminal.

Comments - Although the Supreme Court came to the same conclusion as the Court of Appeal, it reached it via a different route. The Court of Appeal had relied on the 'absurdity' of a narrow interpretation of the word 'machine', whereas the Supreme Court focused on the functions of the RNG and the terminals.

HMRC v The Rank Group [2015] UKSC 48

Was the redemption of vouchers an exempt supply?

Summary - The UT held that a commission charged by clubs, paid by exotic dancers on the redemption of vouchers that had been purchased by patrons, was for services which went beyond dealing with security for money.

The appellants operated table dancing clubs. The dancers were self-employed and paid a fee to gain entry to the clubs. Patrons that had run out of cash were able to purchase club vouchers to pay for the services of the dancers. The clubs charged the dancers a 20% commission on redemption of the vouchers.

Decision:

The first question was whether the vouchers were 'security for money' (VATA 1994 Sch 9 Group 5 item 1) so that they were exempt from VAT. The UT held that the vouchers were given to the dancers by the patrons as 'a security for the money' that they wanted to pay and so were 'security for money'.

The second question was whether the services provided by the clubs in return for the commission were taxable supplies. The UT noted that, in the absence of comprehensive contractual documents, the rights and duties of the dancers had to be drawn from such documentation as did exist, together with the way the clubs conducted their business. The scope of the supply must be determined not only by the final step in the transaction (the presentation of the vouchers for payment), but also the whole scheme.

The benefit that the dancers derived from the vouchers was the right to be included in the scheme, which the clubs set up for patrons to be able to pay for entertainment at the club even though they had no cash. Furthermore, the clubs provided a bundle of services to the dancers, so that they could make the best use of the facilities. It would be artificial to split the voucher scheme from the other services provided by the clubs. Those services constituted a taxable supply.

Comments - Although the transaction at issue was the redemption of a security, it did not fall within the scope of the exemption as the final step of the transaction should not be looked at in isolation but in the context of the business model operated by the parties.

Wilton Park, Secrets (Promotions) and others v HMRC [2015] UKUT 343

Did the sale of a new building qualify for zero-rating?

Summary - The FTT held that the sale of a new building, which included the façade of the original building, did not qualify for zero-rating in circumstances where the façade had not been retained to comply with planning permission.

M Lennon & Co appealed against HMRC's determination that a sale of residential property, which had been the object of extensive redevelopment, was an exempt supply, so that input tax attributable to that supply could not be recovered. Under VATA 1994 Sch 8 Group 5, the first grant by a person constructing a building is zero-rated, excluding a conversion, unless it falls within Note 18. This occurs when:

'(a) [the building] is demolished completely to ground level; or

'(b) the part remaining above ground level consists of no more than a façade, the retention of which is a condition or requirement of planning permission'.

Decision:

The issue was therefore whether Note 18 applied. It was accepted that, given that the new building had been built within the blueprint of the original one, no planning consent had been required, so that Note 18(b) did not apply. The FTT accepted that there had been compelling safety reasons for not demolishing the front half façade of the property. However, this could not alter the fact that the property had not been 'demolished completely to ground level' so that Note 18(a) was not in play.

The remaining issue was whether HMRC should have exercised its discretion to treat Note 18(a) as satisfied, even though it was not satisfied as a matter of law. This was a matter of judicial review outside the jurisdiction of the FTT.

Comments - The retention of a front façade will take the sale of a building out of zero-rating, unless the purpose of the retention is compliance with planning consent. Retention for any other purpose will not satisfy the test.

M Lennon & Co v HMRC TC4488

Whether supplies made to company or to shareholders

Summary – The Tribunal found that the services had been provided to the shareholders and not the company

The issue was the VAT treatment of fees charged by solicitors and accountants to D Ltd in relation to a major restructuring involving the insertion of a new holding company. The question was whether the advice had been provided to D Ltd or to its shareholders.

Decision:

The First-tier Tribunal found that, although the engagement letters had been entered with the company, the economic reality was that the company had decided, before the engagement of the advisors, that it wanted to undertake a restructuring exercise. It was not seeking advice on how to restructure but advice on the tax implications for the shareholders and legal services connected with the implementation of the restructuring.

The First-tier Tribunal concluded that the payment by D Ltd for the tax advice and legal services given to the shareholders was an added inducement to persuade them to sell their shares in accordance with the proposal put forward.

The appeal therefore failed on the basis that the services had not been provided to D Ltd. In any event, the services had not been provided for the purpose of D Ltd's business.

Comments – The key question was whether the advice had been provided to D Ltd or to its shareholders. The appeal therefore failed on the basis that the services had not been provided to D Ltd

Danesmoor Ltd v HMRC TC04487

Holding companies and input tax

Summary - The CJEU found that holding companies can deduct input tax to the extent that they are involved in the management of their subsidiaries.

Larentia + Minerva had acquired 98% of the shares in two subsidiaries — constituted in the form of limited partnerships — which it provided with administrative and business services. Marenave had increased its capital and acquired shares in four 'limited shipping partnerships', and was involved in their management.

The issue was the extent to which deductions were allowed, in relation to input tax incurred on acquisition and issue costs.

Decision:

The CJEU observed that the holding of shares is not an economic activity, unless the holding is accompanied by direct or indirect involvement in the management of the company. Furthermore, for VAT to be deductible, the input transactions must have a direct and immediate link with the output transactions giving rise to a right of deduction.

The CJEU concluded that the expenditure connected with the acquisition of shareholdings in subsidiaries incurred by a holding company which involved itself in their management — and which, on that basis, carried out an economic activity — must be regarded as attributed to that company's economic activity; and therefore that VAT incurred on that expenditure was deductible. The deduction of VAT would only be limited if the costs were attributed in part to other subsidiaries, in the management of which the holding companies were not involved.

Finally, the CJEU found that the Sixth Directive art 4 precludes national legislation which reserves the right to form a VAT group solely to 'entities with legal personality and linked to the controlling company of that group in a relationship of subordination'; except where those two requirements are appropriate and necessary to prevent abusive practices or to combat tax evasion or tax avoidance.

Comments - This decision confirms that VAT incurred by holding companies involved in the management of their subsidiaries is deductible. Some uncertainty as to the required level of involvement may remain, however.

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

Global accounting scheme

Summary – The Tribunal found against the taxpayer in their use of the second hand goods scheme

The taxpayer, a business dealing in salvaged car parts, was assessed by HMRC for £22,000 in relation to its 2010 VAT returns after failing to comply with the accounting conditions of the global accounting scheme. In the absence of proper accounting records and non-compliance with the scheme in 2010, the assessments were based on the full selling price of the goods.

The scheme allows a business trading in secondhand goods to account for output tax on its profit margin rather than the full selling price. It is similar to the secondhand margin scheme but does not require each item bought and sold by the business to be identified in a stock book — a business can declare output tax on its total margin for the VAT period in question. It does not apply to items sold for more than £500 and has the advantage that a negative margin in a period can be carried forward and added to the purchases figure in the next period.

The taxpayer appealed against the assessments, saying HMRC had not taken into account the purchase cost of stock or the sales value of customer returns.

Decision:

The First-tier Tribunal said the taxpayer had not produced any data to show HMRC's calculations were incorrect. The judge said he had “no reason to think” that the business owners had “done anything but their honest best”, but he had to decide the appeal on the evidence before it.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, said: “Many business owners just assume they can use a margin scheme because they are trading in secondhand goods but fail to appreciate that it is, in effect, a concession within the legislation and therefore HMRC have wide powers to insist on strict record keeping requirements as per *VAT Notice 718*. If these conditions are not met, HMRC will usually act quickly to assess tax based on selling prices rather than profit margins.”

R&M Stansfield Enterprises Ltd v HMRC TC4420

Educational aim

Summary – The Tribunal found against HMRC in the appeal regarding the repayment of VAT

From 1973 until the end of July 1994, the BBC charged and accounted for VAT on the services it had supplied to the Open University. From 1 August 1994, the HMRC agreed that the services were exempt under VATA 1994, Sch 9 group 6 item 4, as services provided by an eligible body.

In 2009, the BBC claimed a repayment, under s 80, of the VAT on supplies to the university before 1 August 1994. The Revenue rejected the claim. The university requested a review of that decision under s 83B. It made the request rather than the BBC because it had paid the VAT charged to it by the BBC, and the corporation had agreed to pass on to the university any amounts that it recovered from the Revenue.

HMRC allowed the BBC's claim in relation to the period from 1 April 1973 to 28 February 1974, but refused it for the other periods.

The taxpayer appealed to the First-tier Tribunal for supplies made from 1 January 1978 until 31 July 1994.

Three issues arose:

- whether the BBC was a body governed by public law within the meaning of the education exemption;
- if so, whether it also had the requisite educational aim; and
- alternatively, whether the BBC was another organisation defined as having similar objects.

The tribunal decided against the university on the first two issues. However, on the third, it ruled that the BBC could rely on the direct effect of the education exemption, as long as it satisfied the test of similar objects and so the taxpayer's appeal was allowed.

The Revenue appealed to the Upper Tribunal. The university opposed the appeal and said the First-tier Tribunal should have decided the first two issues in its favour.

On the first issue, the Upper Tribunal said the First-tier Tribunal's conclusion that the BBC was not a public body within the meaning of the education exemption was correct. Mr Justice Henderson said: “Once it is accepted that a body governed by public law has to form part of the public administration, I find it very hard to see how the BBC could reasonably be regarded as satisfying that condition, given that it was deliberately established with full operational and editorial independence.”

On the second issue, the judge found that the previous tribunal had erred in law. The BBC not only produced and broadcast educational programmes, but also provided enough in the way of organisation, support and back-up for those programmes to satisfy the structural element of the test in *Stichting Regionaal Opleidingen Centrum Noord-Kennemerland/West-Friesland (Horizon College) v Staatssecretaris van Financiën* (C-434/05) [2008] STC 2145.

Finally, on the third issue, the judge said the BBC was an "other organisation" within the meaning of the education exemption. Construing the exemption strictly, but not restrictively, the judge concluded that the only reasonable conclusion was that "the UK, acting through a combination of the royal prerogative and parliament, had brought about a situation where the BBC had been defined by it as an organisation having the requisite educational aim". The First-tier Tribunal had taken too narrow a view and had erred in law in reaching the opposite conclusion. HMRC's appeal was dismissed.

Comments – This case goes to the root of whether an organisation falls within a specific exemption and following from that what their aims are. However it was clear from the second issue that the BBC clearly met the relevant conditions for the exemption.

The Open University v CRC, Upper Tribunal

Warranty for mechanical breakdown is an insurance product

Summary - The CJEU found that the supply of warranty for mechanical breakdown was an exempt supply of insurance.

Second hand motor vehicle dealers offered purchasers of those vehicles, through the services of Mapfre warranty, a warranty covering the repair of mechanical breakdowns. The issue was whether the services provided by Mapfre warranty constituted 'exempt insurance transactions'.

Decision:

The CJEU noted that the essentials of an insurance transaction are that 'the insurer undertakes, in return for prior payment of a premium, to provide the insured party, in the event of materialisation of the risk covered, with the service agreed when the contract was concluded'. This could include the provision of insurance cover by a taxable person who was not himself an insurer, but who procured such cover for his customers by making use of the services provided by an insurer that assumed the risk insured. It was therefore irrelevant whether the insurance contracts had been entered into by the dealers or by their customers. Furthermore, the method of calculating the premiums and of managing the repair costs was a matter for Mapfre warranty's internal organisation; and had no bearing on the categorisation of the services it provided.

Finally, the sale of a second hand vehicle together with a warranty did not constitute a single supply. The service of the warranty was not ancillary to the sale of the car and 'it would not be artificial' to split the two supplies. A customer could purchase a car without the warranty or decide to obtain the warranty from a different supplier. Furthermore, the termination of the warranty would not affect the sale of the car.

Comments - The case is a reminder that the concept of 'insurance' covers a wide range of services. It is also worth noting that the CJEU accepted that, in some cases, the national courts may find that a supply of goods together with a supply of warranty constitutes a single supply. However, this was not the case here.

Directeur général des finances publiques v Mapfre asistencia compania internacional de seguros y reaseguros SA and Mapfre warranty SpA v Directeur général des finances publiques (C-584/13)

Forfeiture under a sale and leaseback

Summary - The CJEU found that the forfeiture of a property subject to a sale and leaseback did not give rise to a right to repayment of VAT.

Domino had entered into a sale and leaseback of property with a bank, NLB. NLB had paid VAT on the rental payments invoiced to Domino under the lease. Since Domino had not paid all the instalments due to NLB on expiry of the lease, NLB had taken possession of the property. NLB had then sold it to a third party and paid the surplus proceeds of sale to Domino.

The first question was whether the grant of the lease was a supply of goods or services. On the basis that the lease transferred all the risks and rewards of legal ownership to the lessee, the CJEU found that it must be treated as the acquisition of capital goods.

The second question was whether the non-payment by Domino constituted a 'cancellation, refusal, total or partial non-payment' under the sixth VAT Directive art 90(1). The CJEU found that it was not so in circumstances where NLB had received all the payments.

Finally, the principle of fiscal neutrality did not preclude the taxation of both the amounts receivable under the lease and the amount receivable on disposal of the property, provided that the two transactions did not form a single supply.

Comments - This case confirms that Article 90(1) does not permit a trader to reduce the taxable amount where the trader has received all the payments in consideration for the service supplied.

NLB Leasing d.o.o. v Republika Slovenija (C-209/14)

Is the transport of human organs and samples exempt?

Summary - The CJEU found that services provided by a transporter of human organs and samples did not qualify for the medical care exemption.

Ms De Fruytier transported human organs and samples for hospitals and laboratories under medical supervision.

Decision:

The CJEU had found (C-237/09) that these activities were not exempt from VAT under the Sixth Directive art 13(A)(1)(d), but Ms De Fruytier now argued that the services were exempt under art 13(A)(1)(b) as an activity 'closely related to services of a medical nature'.

The court stressed that it had already held that the concept of activities 'closely related' to 'hospital or medical care' within the meaning of the Sixth Directive art 13(A) (1)(b) does not cover activities such as the collection and transport of blood, 'where the medical care provided in a hospital environment to which those activities are merely potentially related has not been performed, commenced or yet envisaged' (*Future Health Technologies* (C-86/09)).

Only the supply of services which were logically part of the provision of hospital and medical care services, and which constituted an indispensable stage in the process of the supply of those services to achieve their therapeutic objectives, was capable of amounting to 'closely related activities'. This was not the case for Ms De Fruytier's activities. Furthermore, a self-employed transporter such as Ms De Fruytier was not an entity performing the same type of function as a hospital. She was therefore not 'an establishment of a similar nature'.

Comments - The confines of the exemption for medical care remain sometimes hazy. This case confirms that transporters of human organs and/or samples are unlikely to satisfy the stringent tests contained in art 13(A).

The Belgian State v Nathalie De Fruytier (C-334/14)

So what is the VAT reverse charge? (Lecture B910 – 10.12 minutes)

The reverse charge is in point when a UK VAT registered trader buys in services from an overseas supplier. The service provider could be EU or non-EU.

Reverse charges do not apply if the service would ordinarily be zero rated or exempt.

The relevant legislation is found in S8 VATA 1994.

VAT return entries

The effect of the reverse charge is that the supply is treated as if the UK trader had made the sale themselves and so they record the equivalent UK VAT in Box 1 of their VAT return and the net value of the supply in Box 6.

The net value of the purchase is recorded in Box 7 and the amount of VAT recoverable after adjusting for any partial exemption adjustment is placed in Box 4.

Nothing goes in Box 8 or Box 9 as these boxes are for goods only.

Illustration

An engineering company engages the services of a German consulting firm for £10,000. No German VAT is due on this B2B supply. By applying the reverse charge mechanism, the engineering company will have the following VAT return entries:

Box 1 £2,000

Box 4 £2,000

Box 6 £10,000

Box 7 £10,000

Why does the reverse charge exist?

The reverse charge ensures that there is no VAT reason for choosing one supplier over another supplier.

Let's assume that we have a UK partially exempt VAT registered trader who makes 30% taxable supplies. If they buy in a service costing £10,000 before VAT we can compare the position for VAT by using either a UK or overseas supplier:

	UK supplier	**Overseas supplier**
Paid to supplier	**£12,000** (Includes £2,000 VAT)	**£10,000** (No VAT on invoice)
VAT return		
Box 1	Nil	**£2,000**
Box 4	**£600** (2,000 x 30%)	**£600**
Box 6	Nil	£10,000
Box 7	£10,000	£10,000
Net cost	**£11,400**	**£11,400**
	(12,000 – 600)	(10,000 + 2,000 – 600)

Flat rate traders

Flat rate traders buying **goods** from overseas has disastrous results because:

- Importing goods from outside the EU will result in non-recoverable import VAT
- Acquiring goods from the EU will result in non-recoverable Box 2 acquisition VAT

However if the flat rate trader is buying services from outside the UK then normal reverse charge rules apply and VAT can be recovered in Box 4 (VAT Notice 733 para 6.4).

Unregistered traders

When buying in services from outside the UK, an unregistered UK trader should not be charge VAT by their overseas supplier. As the UK trader is not VAT registered, he cannot operate the reverse charge but the sale will count as income for the purposes of the UK VAT registration threshold of the UK unregistered trader. This could result in the trader needing to register earlier than they had expected.

Time of supply

The time of supply determines which VAT return the reverse charge should be recorded. Remember failure to record a supply in the correct period could result in penalties.

For a single supply the time of supplier is the earlier of completion of the service or payment while for a continuous supply it is the earlier of each periodic billing period or payment. There is a compulsory tax point of 31 December where there is no periodic billing period agreed.

Note that the date of the invoice is irrelevant in both cases.