Tolley®CPD

October 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.

Tolley® Tax intelligence from LexisNexis®

Contents

Personal Tax 5

- Value of securities should reflect restrictions 5
- No proper salary sacrifice confirmed by the Court of Appeal 6
- Success at the final hurdle for the tax being due when approval was withdrawn 7
- Pension contributions in 2015/16 and beyond (Lecture P916 – 24.10 minutes) 8
- New pension freedom – Lifetime benefits (Lecture P917 - 24.06 minutes) 12
- New pension freedom – Death benefits (Lecture P918 - 14.54 minutes) 15

Capital Taxes 16

- Not part of the garden – PPRR available? 16
- Was payment to facilitate sale CGT deductible? (Lecture P919 – 9.23 minutes) 16
- Defective deed of variation resolved by rectification 18

Administration 19

- Reasonable steps taken as further knowledge of CIS not required 19
- Omitted pension – What is appropriate penalty? 20
- No penalties before incorporation as determination of the taxpayer is important 21
- Special relief agreed because of vulnerability of taxpayer 22
- Penalties not unfair, disproportionate or unduly onerous 23
- Late-filing penalties quashed as income below PA so no SATR due 24
- Careless HMRC official not taxpayer 25
- Lack of evidence is not an inaccuracy 26
- Whether the notification of an assessment was valid as details were missing 26
- Partner payment notices were validly issued 27
- Use of the capital loss and judicial review 28
- The jurisdiction of the FTT over special relief 29
- Suspended penalty decision by FTT 30
- Late applications refused 30
- No co-operation by taxpayers 30
- Inordinate delay by taxpayers 31
- Unconvinced by taxpayer’s argument re delay 31
- Auto enrolment – current tasks Autumn 2015 (Lecture B918 – 8.31 minutes) 32
- Auto enrolment – The importance of postponement (Lecture B919 – 9.40 minutes) 35
- Update on HMRC’s Digital Strategy (Lecture P920 – 18.40 minutes) 40
- Deadline Dates 44

HMRC News 46
Autum Statement 2015 46
Finance (No. 2) Bill 2015 46
SI 2015/1670 The Pensions Act 2014 (Commencement No. 6) Order 2015 46
Simplification of the tax and NI treatment of termination payments 46
The Scottish Rate of Income Tax 46
Taxman brings in record £1 billion from avoidance crackdown 48
Travel and subsistence discussion paper 48
HMRC Practice announcement on Anson SC case 53

Business Taxation 55
What is an institutional investor (for R&D)? 55
Penalties reduced for CIS failures 56
For whose benefit was the expenditure incurred – Private or business? 57
The onus of proof lies with the taxpayer – Proof of innocence? 58
The limits of territoriality and the Construction Industry Scheme 59
Film Schemes and Trading – Goldcrest Film Scheme 60
Tax and accounting standards 61
Main object of transaction – Obtaining of capital allowances? 62
Discontinued but when – Important for AIA? 63
Does Dutch withholding tax comply with EU law? 64
Dividends and the freedom of establishment 65
Planning for the new 2016 dividend changes (Lecture B916 – 18.31 minutes)/(Lecture B917 – 21.02 minutes) 66

VAT 66
Harsh but not unfair – UT reverses FTT 74
Is Bridge a sport? 75
Residual input tax is recoverable 75
Overclaimed input tax not allowed 76
Exclusive occupation of land exempt not standard rated 77
Golfing VAT arrangement abusive 78
Bitcoin exchange transactions tax treatment 79
Medical care provided by subcontractors and contractors 79
Optional insurance provided with car hire was a separate supply 80
Cattle supplies – VAT treatment? 81
Evidencing an overpayment of VAT as matter of fact 81
Retrospective inclusion of a company into a VAT group 83
Pre-registration input tax – have HMRC moved the goalposts? (Lecture B920 – 14.08 minutes) 84

Personal Tax

Value of securities should reflect restrictions

Summary - The FTT found that shares released to an employee on the termination of his employment were restricted securities.

Mr Sjumarken was employed by BNP Paribas as an investment banker. The taxpayer was made redundant from the London branch in October 2005. Under the terms of his compromise agreement, his shares in the bank's share incentive plan (SIP) and cash from its cash incentive plan (CIP) were released.

The issues in dispute were:

- the correct valuation of the SIP shares;
- whether they should be valued as 'restricted' shares; and
- whether Mr Sjumarken had provided consideration to BNP by giving up his long dated options

In a hearing before the First-tier Tribunal, the judge found that the evidence against the plans being tax approved was “overwhelming” and dismissed the appeal. The case was reheard because of a “procedural irregularity”.

The parties now agreed that neither the SIP nor the CIP were approved schemes.

Decision:

The First-tier Tribunal concluded that the employer operated restrictions on the SIP shares and these should be reflected in their market value. Mr Sjumarken had given evidence that he had been told previously by a representative of BNP that the shares were restricted; and, more significantly, that it had not been possible to sell all of his shares, which could only be sold in tranches. The judge left it to the parties to agree a valuation on that basis.

The tribunal did not accept that giving up the long-dated options could be treated as consideration from Mr Sjumarken to the bank. It was clear that they had been cancelled as a result of the compromise agreement. There was no evidence that the sum paid to the taxpayer excluded any value relating to those options.

The taxpayer's appeal was consequently allowed in part.

Comments - Although the legal documentation suggested that the shares were not restricted, the FTT accepted that they had been treated as such and they should therefore be valued as restricted shares. The field of employment related securities is one of the most difficult areas of employment tax and particularly so where internationally mobile employees are involved.

Lars Sjumarken v HMRC TC4557

No proper salary sacrifice confirmed by the Court of Appeal

Summary – Again in a long judicial saga, the Court of Appeal has dismissed Reed's appeal, finding that the salaries of its temporary workers (temps) had not been reduced as a consequence of the schemes.

Reed Employment operated two schemes, the Reed travel allowance (RTA) and the Reed travel benefit (RTB), to pay travel expenses to employed temporary workers. It claimed that these amounted to salary sacrifice arrangements, that allowed the company to pay the workers a smaller salary than would otherwise have been the case, together with contractually separate payments made for travel expenses.

HMRC disagreed, saying that the travel expense payments were subject to PAYE tax and National Insurance. The company appealed.

The First-tier Tribunal and Upper Tribunal found in favour of HMRC.

The principal issue was whether, under the employed temps' contracts of employment, Reed:

I. made payments reimbursing the employed temps' travel expenses, in addition to paying their wages; or

II. made a single global payment, in which the payment on account of travel expenses was simply part of the employed temps' overall wages.

Decision:

Lord Justice Lewison in the Court of Appeal stated that, under both arrangements, the employed temp was entitled to be paid the product of the agreed hourly rate and the number of hours. It was clear that this was what the worker expected and that the amount would be taxed as earnings. Consequently scenario ii applied.

The judge said: “The answer to the question 'will I receive less pay?' given by the staff handbook is an unequivocal 'no'. That is quite the opposite of saying that you will receive less pay, but you will receive an additional travel allowance to make up for it.”

Similarly, the payslips did not show that workers had agreed to a reduced wage plus a tax-free travel allowance.

The company's appeal was dismissed.

Comments – With the amount in dispute representing approximately £158m, the litigation involved both a tax appeal on the substantive issues and an application for judicial review. The Court of Appeal, not surprisingly in light of the history of the case, found against Reed unanimously, in circumstances where neither the legal documentation nor the communications to employees suggested a reduction of remuneration.

Reed Employment v CRC, Court of Appeal

Success at the final hurdle for the tax being due when approval was withdrawn

Summary – The Supreme Court allowed the appeal, thereby imposing a stringent time limit on HMRC for imposing the charge to tax on the loss of approval by pension schemes.

In April 2000, HMRC notified the administrator of the John Mander Ltd Directors Pension Scheme that approval under TA 1988, s 591B(1) was withdrawn with effect from 5 November 1996. In July 2000, they issued an assessment for 2000/01 under s 591C to the then administrator. In January 2007, a fresh assessment was raised against the new administrator.

The taxpayer appealed against both assessments, on the ground that the tax related to 1996/97 when withdrawal of approval had taken effect. The First-tier Tribunal, Upper Tribunal and Court of Appeal found against the taxpayer, saying the tax was assessable in the year 2000/01 when the withdrawal was notified to the administrator.

The key question was whether the tax charge fell to be assessed in the tax year with effect from which the approval ceased (1996/97), or in the tax year when HMRC's decision to withdraw approval was notified to the administrator of the scheme (2000/01).

The taxpayer appealed.

Decision:

The decision by Lord Sumption in the Supreme Court was that, according to s 591, tax was assessable in the chargeable period from which the approval ceased to have effect under the statutory notice of withdrawal. "Cessation of approval" in s 591C(2) referred to the opening words of s 591(C)(1). This identified the condition on which the charge to tax arose. In a case that fell under s 591B(1), this meant the date in HMRC's notice from which approval was withdrawn. If the charge to tax had arisen at the date of assessment, the chargeable period would have been wholly at the discretion of HMRC, creating the possibility that a charge might be imposed many years after the facts which justified it.

The Revenue had not been entitled to assess the administrator of the taxpayer's scheme to tax under s 591B(1) for 2000/01.

The taxpayer's appeal was allowed (with Lord Carnwath and Lord Hodge dissenting).

Comments – This was a lead case for a number of appeals awaiting decisions in the FTT. The decision of the Supreme Court means that, in many cases, it will be too late for HMRC to raise assessments. Additionally the decision should be perceived as equitable preventing the chargeable period being wholly at the discretion of HMRC. This case demonstrates how persistence can pay off where you believe you are right as demonstrated by the success at the final hurdle.

John Mander Pension Trustees Ltd v CRC,
[2015] UKSC 56

Pension contributions in 2015/16 and beyond (Lecture P916 – 24.10 minutes)

From 6 April 2015 pension freedom applies to all money purchase schemes including personal pension plans, SIPPs and stakeholder schemes. This applies to savings pre and post 6 April 2015 with all schemes moving over to the new regime.

Under the new regime, when you reach 55 you will be able to take money from your pension plan by way or a lump sum and/or income. There are also greater opportunities to pass your residual pension fund IHT free to any nominated beneficiary when you die. It will not be restricted to spouses or dependants.

The pension providers are not obliged to offer all the attributes of pension freedom but in a competitive market it is envisaged that most will do so. Some smaller providers may only offer certain aspects of pension freedom. In these instances the individual could transfer their fund to a pension provider that does offer full pension freedom.

The new options will have associated charges, such as a flat fee for uncrystallised fund pension lump sum (UFPLS).

Pension contributions

The maximum amount an individual is permitted to pay each year is the higher of:

- £3,600, and
- Relevant (taxable) earnings

Employer contributions are not restricted to relevant earnings. Any employer contributions must be made wholly and exclusively in order for the employer to receive a corporation tax deduction. This should not be an issue when the benefit package (salary, car, pensions etc) is simply paying out corporate profits.

An individual could be adopting a low salary, high dividend extraction route through their company. The salary could well be set at the personal allowance so as to utilise the £2,000 employers NI exemption in 2015/16. Dividends would be taken over and above the salary amount.

In 2016/17 the salary may well reduce to the national insurance limit as the employer NI exemption will not apply to one-man companies.

In this situation, personal pension contributions must not exceed £10,600 but the employer contributions are unrestricted.

Due consideration should however be given to the annual allowance of £40,000 and the lifetime allowance of £1.25m (reducing to £1m from April 2016). Protection is available where the pension fund is currently in excess of £1m.

The maximum contributions qualifying for tax relief each year are:

- £40,000 Annual Allowance (AA), or
- £10,000 Money Purchase Annual Allowance (MPAA)

Tax relief is given at your marginal rate with any excess reported on the individuals self-assessment return at Page Ai4, Boxes 7 – 12.

Annual Allowance (AA)

The annual allowance is £40,000.

All contributions into the taxpayer's pension schemes are compared to this limit. Generally this will be the individual's contributions plus any contributions made by the employer.

Any contributions in excess of the £40,000 are treated as income and taxed accordingly via the self-assessment return.

From April 2016 the annual allowance is reduced by £1 for every £2 that your income exceeds £150,000 until it reaches £10,000. The minimum £10,000 allowance will be reached when your income reaches £210,000.

Pension input periods (PIP)

Tax relief is given on a paid basis but the annual allowance charge is considered for the PIP ending in the tax year.

Many PIPs are aligned with the tax year but some are anniversary date of the scheme commencement.

So if contributions exceeded £40,000 in the PIP to 30 June 2014 there would be an annual allowance charge on the 2014/15 self-assessment return (unless there was unused relief brought forward in 2014/15).

Due to the introduction of taper for high earning individuals, the rules for PIPs are to change. The result of the change is that all PIPs came to an end on 8 July 2015. New PIPs started for all contributors on 9 July 2015 and will run to 5 April 2016. All future PIPs will be aligned to the tax year, and there will be no possibility of electing for a change in PIP.

Contributors will have either two of three PIPs falling in the tax year 2015-16, depending on when their previous PIP end date was.

Example 1

Tom has a single pension arrangement with a PIP end date of 30 June. His contribution of £40,000 made in March 2015 is in PIP to 30 June 2015 and this would have been checked against the 2015/16 annual allowance.

Tom was expecting to make a further contribution of £40,000 in March 2016, which would have fallen into the 2016/17 year for annual allowance purposes i.e. the PIP year to 30 June 2016.

However, the PIP starting on 1 July 2015 was brought to an end on 8 July 2015, and a new PIP started on 9 July 2015, which will run until 5 April 2016.

Tom therefore has three PIPs in the tax year 2015/16:

- 1 July 2014 to 30 June 2015
- 1 July 2015 to 8 July 2015
- 9 July 2015 to 5 April 2016

Tom made a contribution of £40k in March 2015 and another £40k in March 2016. Both contributions will fall into the 2015/16 year for annual allowance purposes making total contributions of £80,000. This exceeds the normal £40,000 so an enhanced annual allowance of £80,000 has been introduced for 2015/16.

Enhanced annual allowance

The tax year 2015-16 is to be regarded as two separate tax years:

- 6 April 2015 to 8 July 2015 (pre-alignment tax year), and
- 9 July 2015 to 5 April 2016 (post alignment tax year)

The two notional tax years will be aggregated for annual allowance purposes. The annual allowance for PIPs ending in the pre alignment tax year is £80,000. The annual allowance for PIPs ending in the post alignment tax year is £nil. The balance of the £80,000 may be carried forward to the post alignment tax year subject to a maximum carry forward of £40,000.

This will allow Tom (Example 1) to make his full £40,000 contribution in March 2016 as he has not utilised his £80,000 limit for PIPs to 30 June 2015 and 8 July 2015.

Example 2

Jane's pension fund has a PIP end date of 30 June. Jane normally makes an annual contribution in late April which ties in with her annual bonus. In line with previous years Jane contributed £40,000 to this arrangement in April 2015.

She was then advised to make a further contribution of £40,000 in March 2016. The advice was given so that her 2015/16 contributions of £80,000 are covered by her enhanced allowance and she has avoided 2016/17 taper on her second contribution.

Money Purchase Annual Allowance (MPAA)

The £40,000 annual allowance is replaced by a £10,000 MPAA when the client draws income under flexi-access drawdown or where the client takes an UFPLS.

There is no carry forward of unused MPAA.

The MPAA will not be triggered if you just take the 25% tax free lump sum.

Contributions in excess of the MPAA are treated as income on the self-assessment return.

In the year of first income drawdown the £40k annual allowance applies to the whole year whereas the £10k MPAA applies to money purchase contributions post drawdown.

In subsequent years just the MPAA applies. It would therefore be prudent to utilise the £40,000 annual allowance before going into income drawdown.

Example 3

James is a sole trader accountant with profits of £70,000 per annum. His pension fund is valued at £500,000 on his 55th birthday and he decides to take his 25% tax free sum of £125,000 on his 55th birthday.

He plans to carry on trading for another 10 years. His future contributions are subject to the annual allowance limit of £40,000 per annum. The MPAA does not apply until he goes into income drawdown. As a high rate taxpayer it would not be sensible to go into income drawdown at this stage.

If you have a final salary scheme and a money purchase scheme the MPAA only applies to the money purchase scheme.

The MPAA rules have been brought in to restrict churning to just £10,000 per annum.

Annual Allowance Carry Forward

Providing an individual has a pension plan in the tax year, any unused annual allowance can be carried forward and used in any of the next three years.

The annual allowance limits are as follows:

2012/13	£50,000
2013/14	£50,000
2014/15	£40,000
2015/16	£40,000 (+ £40,000)

The current year is always utilised first followed by previous years on a FIFO basis.

There is no carry forward once the £10,000 MPAA is in point so it is advisable to utilise all carry forward amounts before going into income drawdown.

The future

As a general rule, both spouses should aim to have pension funds so that they can utilise both base rate bands in retirement. If one spouse has a good sized fund then maybe they should start to shift contributions to spouse. If either spouse dies < 75 you have “tax free wrapper”.

If you are likely to approach the £1m lifetime limit consider shifting contributions into ISAs.

The Chancellor is considering removing tax relief on pension contributions coupled with no tax on maturity. The so called “Pensions ISA” has not been well received!

New pension freedom – Lifetime benefits (Lecture P917 - 24.06 minutes)

The pre April 2015 regime

Until the end of 2014/15 we had capped and flexible drawdown options. Both offered a form of income drawdown but lacked the freedom that the post April 2015 rules offer.

There are transitional rules for those in capped or flexible drawdown pre 6 April 2015.

Those previously in capped drawdown can continue such an arrangement post April 2015 and contribute up to £40k pa. They are not subject to the MPAA even though they are in income drawdown.

Those previously in flexible drawdown were not permitted to make annual contributions pre April 2015 whereas now they can contribute up to £10k pa.

The post April 2015 regime

The benefit changes apply to defined contribution schemes from April 2015.

As soon as the individual is 55 years old they can choose between flexi-access drawdown or an UFPLS.

Free impartial advice is offered via the government backed “Pension Wise” website.

Flexi-access drawdown fund

Funds placed in a "flexi-access drawdown fund“ may be withdrawn in any amount over any period.

Up to 25% of the value transferred may be taken as a tax free pension commencement lump sum. Any further draws are treated as income and taxed at the marginal rate of the beneficiary.

An individual in flexi-access <u>income</u> drawdown is subject to the MPAA, with tax relief reduced from £40,000 to £10,000 per year. It should be noted that just drawing the lump sum does <u>not</u> trigger the £10k MPAA.

Example 1

Mr D is 66 and has an income of £7,600 per annum from his State Pension. He has a defined contribution pot of £100,000 and decides to take £55,000 from his pension fund. Of the £55,000 lump sum, £25,000 will be tax free i.e. £100,000 @ 25%. The balance of £30,000 will be treated as income.

Of the £30,000 income withdrawal, £3,000 will be taxed at 0% as this falls within the personal allowance of £10,600, when combined with his state pension of £7,600.

The remaining £27,000 would then be taxed at 20%.

In year 2, Mr D takes the full £45,000 left in his pension pot. Assuming the tax thresholds remain unchanged in year 2:

- the first £3,000 and his State Pension will be taxed at 0%
- the next £31,785 will be taxed at 20% and
- the final £10,215 will be taxed at the higher rate of 40%.

It should be noted that tax will be withheld at source on any income draws.

Uncrystallised funds pension lump sum (UFPLS)

The first 25% of each draw will be tax free, with the remainder taxable as income. Tax will be deducted at source on the 75% income element.

When you reach 55 you can take a one-off UFPLS or a series of UFPLS. Pension funds may impose charges and/or minimum withdrawals for an UFPLS. An individual who is in UFPLS drawdown will thereafter be subject to new MPAA with tax relief reduced to £10,000 per year.

Example 2

Mr A is 55 with income of £90,000 per annum and a defined contribution pot of £400,000. His options are as follows:

Flexi-access:

- £100,000 tax free sum
- Any further draw would be taxed at a minimum of 40% and result in the MPAA applying.

UFPLS:

- Draw any amount and have a 25% tax free, 75% income split on the withdrawal
- The MPAA applies

Alternatively a mixture of the above could be considered but you cannot have UFPLS on a flexi-access crystallised fund.

It might be tempting to take just the £100,000 flexi-access tax free sum and carry on making annual contributions up to £40,000 pa. The new contributions will be to a new pension fund and as such he will have a flexi-access option on this new fund. Once retired he can draw income so that he is just below the high rate band.

Tax refunds

PAYE income tax will be applied by the pension administrator to the income elements of any pension drawdowns. The tax code is likely to be “1060L Month 1”. In 2015/16 this gives tax free personal allowances of £833 per month and a basic rate band of £2,649 per month.

Example 3

If a taxpayer draws £6,000 under UFPLS in 2015/16:

- First £1,500 = 25% tax free
- Next £833 = Covered by the personal allowance
- Next £2,649 @ 20% = £529.80
- Remaining £316 @ 40% = £126.40

If no other draws are planned for 2015/16 then tax has been overpaid.

There are three options for recovering the tax on flexi access and UFPLS overpayments:

1. Complete HMRCs new Form P55 in the year (if no further draws expected in the year)
2. Contact HMRC and see if they will issue a revised coding notice to pension provider
3. Completing the self assessment return at end of the tax year

Form P55 is available online. If the client has taken all their pension pot then Forms P53Z or P50Z will be needed.

Annuities…

Post April 2015 you do not have to buy an annuity at any point.

Many individuals will still opt for a 25% tax free sum and buy an annuity with the balance. Annuities have low risk whereas flexi-access drawdown or UFPLS is subject to market forces.

There are various types of annuity available including:

- Single life
- Joint life (with anyone of your choosing)
- Fixed term
- Investment-linked
- Flexible or variable
- Enhanced…

Post April 2015 annuities include decreasing term plans where you take more now and less when your state pension kicks in.

Post April 2015 guaranteed term annuities are not restricted to five or ten years

It should be noted that only flexible annuities trigger the MPAA of £10,000 pa.

Conclusion

Whilst flexi-access drawdown and UFPLS are attractive, many risk averse taxpayers will still opt for an annuity – once they have taken their 25% tax free lump sum.

Annuities generally die with the annuity holder but guaranteed term or joint life annuities will have an extended life. Where the annuity holder dies under 75, the remaining annuity payments will be tax free for the beneficiary.

The individual may consider spreading the risk in retirement and go part drawdown, part annuity. This has some attractions.

It should also be noted that the Chancellor is aiming to bring in rules that allow annuities to be sold post April 2016.

For those individuals intent on using the new pension freedom they should take advice early and plan the use of their fund(s). Pensions are very much part of IHT planning under this new regime.

New pension freedom – Death benefits (Lecture P918 - 14.54 minutes)

Where the pension holder dies under the age of 75 the fund can pass IHT free to nominated beneficiaries. The beneficiary is then able to take a lump sum or regular income withdrawals from the fund completely free of income tax. The beneficiary does not have to wait until they are 55 to enjoy tax free withdrawals from the deceased's pension fund.

Where the pension holder dies over the age of 75 the fund can pass IHT free to nominated beneficiaries. The beneficiary is then able to take a lump sum or regular income withdrawals from the fund but both will be subject to income tax. If the lump sum is taken prior to 6 April 2016 it will be taxed at 45%. All other withdrawals are subject to the beneficiary's marginal rate of tax.

Example 1

James is 68 when he dies in flexi-access drawdown. He leaves the pension fund to Beth, a 77 year old friend. As James was under 75 when he died, Beth can take a tax free lump sum or draw tax free income.

When Beth dies she leaves the fund to her son Frank. As Beth was over 75 on her death, Frank can take a taxable lump sum or taxable income draws from the fund.

Frank leaves the fund to his daughter Amy. Frank dies at 74. Amy can draw a tax free lump sum or tax free income as Frank was under 75 when he died.

Example 2

Chris and Diane have a large buy to let investment portfolio and are comfortable in retirement.

When Chris was 55 he drew a tax free sum of £100,000 from his pension fund but he has not drawn any further income from the fund.

As Diane is well catered for Chris has decided to nominate his son Alex as sole beneficiary of his pension fund. Chris dies at 73 and Alex inherits his fathers pension fund. As Chris died under 75, Alex can draw any sum from this fund tax free.

Capital Taxes

Not part of the garden – PPRR available?

Summary - The FTT found that principal private residence relief was not available in relation to the sale of a plot which had formed part of a larger estate but was physically separate and fenced off.

The taxpayers owned a property that included the house in which they lived, a workshop and parking area that they used for their business and two fields. They divided part of the land into five building plots and built a house on plot 4, into which they moved in 2007. They sold the original house a month later and then plot 2 in 2009. They claimed only or main residence relief on the gain on plot 2 on the basis that it was part of plot 4's garden.

HMRC refused the claim, saying plot 2 did not form part of the garden or grounds of plot 4. The taxpayers appealed.

Decision:

The First-tier Tribunal highlighted that plot 2 was separated from plot 4 by plot 3 and that it was fenced off from plots 1 and 3. The judge said the taxpayers had provided no evidence that plot 2 had been used as a garden and the judge therefore concluded that it had never formed part of the garden of plot 4.

The tribunal said the taxpayers were not entitled to claim only or main residence relief on the disposal of plot 2.

The taxpayers' appeal was dismissed.

Comments - The FTT accepted the statement in HMRC's *Capital Gains Manual* (CG64367) that it is possible for a garden to be separated from a residence, but observed that this was unusual. However it needs to be recognised that where this is the case a higher burden is imposed to ensure that PPRR is obtained for the disposal of the separate piece of land. Here, the separation and the fencing off of the land meant that the plot could not be part of the appellants' residence.

Mrs D and Mr I Fountain v HMRC TC4596

Was payment to facilitate sale CGT deductible? (Lecture P919 – 9.23 minutes)

Summary – The UT found that the payment made by a shareholder to enable him to sell his shares more easily was not deductible in the computation of his taxable gain.

The taxpayer held class A, B and C shares in Blackwell Publishing (Holdings) Ltd. In 2003, after an unsuccessful takeover attempt by Taylor & Francis Group plc, the taxpayer entered into an agreement with Taylor & Francis in relation to his A shares in return for £1m.

In 2006, John Wiley & Sons Inc. made an offer for Blackwell for a higher sum than Taylor & Francis had offered in 2003. Taylor & Francis offered to release the taxpayer from the 2003 agreement if he paid them £25m.

In November 2006, the taxpayer entered into a new agreement with Taylor & Francis. This released him from the 2003 agreement and, in return, he paid Taylor & Francis £25m, of which Wiley provided £7.5m and he provided the balance.

Soon afterwards, he sold his Blackwell shares and claimed a deduction under TCGA 1992, s 38(1)(b) of £17.5m (the release fee) on their disposal. That section has, in effect, two limbs: the first relates to expenditure on the asset reflected in the state or nature of the asset; the second relates to the establishment of title to or right over the asset.

HMRC refused the deduction. The First-tier Tribunal allowed the taxpayer's appeal without giving consideration to limb 2 of s 38(1)(b). HMRC appealed.

The Revenue argued that the asset disposed of by the taxpayer had been his shares and that the rights and obligations forming that asset were unaffected by the 2003 and 2006 agreements. The £17.5m expenditure had neither been "on" the asset nor reflected in its state or nature at disposal.

The taxpayer argued that a deduction was permitted under the second limb of s 38(1)(b).

Decision:

Mr Justice Newey in the Upper Tribunal said the asset to which s 38(1)(b) applied was not the asset as it operated in the seller's hands. The asset was the bundle of rights and obligations which would be acquired by a purchaser. On that basis, the £17.5m payment could not be reflected in the state or nature of the asset unless the 2003 agreement would have affected a buyer of the shares, which it did not. In such circumstances, the shares sold by the taxpayer had not been changed by the 2006 agreement. Therefore, its state or nature could not have altered.

The judge concluded that the First-tier Tribunal had made an error of law in finding that the 2006 agreement had changed the state of the taxpayer's shares. At the time of their disposal, the state or nature of the shares had not reflected the money paid under that agreement.

On the taxpayer's argument concerning the second limb of s 38(1)(b), the 2006 agreement had enabled the taxpayer to exercise rights relating to his shares. It had not created or established such rights: the asset had remained the same. Under the 2006 agreement, the taxpayer had not established, preserved or defended any right over his asset.

HMRC's appeal was allowed.

Comments - The UT found that the asset to which s38 TCGA 1992 applied was not the asset as it operated in the vendor's hand, but the bundle of rights and obligations acquired by the purchaser. On this basis, the payment made to ensure that the sale would go through was irrelevant to the computation of his gain. This case which has now appeared in the Upper Tribunal demonstrates how important it is to understand the exact nature of the details of the relevant CGT provisions.

CRC v J Blackwell, [2015] UKUT 418

Defective deed of variation resolved by rectification

Summary – The Court held that an order for rectification was appropriate for a defective deed of variation

The claimants, one of whom was a son of the deceased, were the executors of the deceased. The defendants were the widow and the other two sons of the deceased.

The claimants sought to vary the terms of the deceased's Will so that the residuary estate passed absolutely to the widow instead of to her and the three sons equally. The defendants did not contest the claim.

The deed was ineffective because it did not include a statement by all the parties that IHTA 1984, s 142(1) should apply to the variation.

Decision:

The judge said there was sufficient evidence to satisfy the burden of proof required in a rectification claim. He also added:

> “There are real issues which fall to be resolved between the parties if an order for rectification is made.
>
> There will be a repayment of a substantial sum by way of inheritance tax or, alternatively, if the sum has not yet been paid, there will be a release from the liability for inheritance tax in a substantial sum because a gift to a widow made by a document taking effect as part of the will is an exempt transfer.
>
> The gift will also affect the cumulative total of transfers of value should any of the three sons fail to survive for seven years from the deed of variation.”

He was satisfied that these issues would be resolved by an order for rectification. The claim was allowed.

Comments – A deed of variation is a very useful document which can fundamentally alter the distribution of the estate and potentially save tax. However it is essential that the right procedures are followed – in this case they were not and therefore the rectification was required. It is worrying the number of cases that come before the Courts where rectification is required when the documents should have been correctly drafted in the first place

Vaughan-Jones and another v Vaughan-Jones and others, Chancery Division

Administration

Reasonable steps taken as further knowledge of CIS not required

Summary – The Tribunal held that the taxpayer had a reasonable excuse.

The taxpayer was a jobbing builder. He employed an accountant to deal with his business's PAYE. During the years 2006/07 to 2010/11, he failed to make construction industry scheme deductions to subcontractors' pay or submit returns. HMRC issued determinations under the Income Tax (Construction Industry Scheme) Regulations 2005/2045, regulation 13. They also imposed penalties of £40,332 under TMA 1970, s 98A(2)(a)for late returns.

The taxpayer appealed. The department offered to mitigate the penalties under s 102 to £3,196 and confirmed that the offer would remain if the appeal was decided against the taxpayer.

The taxpayer claimed reasonable excuse for the failures. He had appointed an accountant to organise all relevant filings and provide advice. He had no reason to believe the adviser would not carry out the services properly.

Decision:

The First-tier Tribunal observed that, as the taxpayer had been a self-employed builder since about 2000, he had some experience of the construction industry scheme. However, it was reasonable for him to have employed an accountant who claimed to offer a comprehensive tax and accounting service for small businesses. Having done that, there was no reason for the taxpayer to have taken additional steps to familiarise himself with his construction industry scheme obligations, whether by obtaining a second opinion, contacting HMRC or checking HMRC's guidance.

The tribunal said the test was one of reasonableness and "no higher or lower standard should be applied". There was no universal rule in that what might be considered an unreasonable failure by one taxpayer might not be so regarded in the case of another.

On the fact that the taxpayer had previous experience of a deduction scheme in the construction industry, the judge noted that this was in the context of larger projects, and would have given him no insight into the filing obligations of a contractor. He had provided the accountant with the paperwork to prepare his accounts, including reference to expense incurred in relation to subcontractors. Having done so, he was entitled to rely on that accountant to draw attention to any relevant filing obligation. It was also "reasonable for such a taxpayer to have concluded, from his accountant's silence, that there were no such obligations outstanding".

The taxpayer was "an ordinary small trader" who could not "be imbued with any particular sophistication or knowledge of the construction industry scheme".

The judge concluded that it was not unreasonable for such a taxpayer not to have been aware of the construction industry scheme filing obligations: "This is not a case in which a taxpayer, knowing of an obligation, merely delegates that task to a third party and does not take reasonable steps to ensure that it has been undertaken."

The taxpayer had reasonable excuse for the non-filing of the construction industry scheme returns and the penalties were set aside.

The taxpayer's appeal in relation to penalties was allowed, but the appeal against the regulation 13 determinations was dismissed.

Comments – This case is a good illustration in the decision of the rationale of a reasonable excuse. It highlights a number of reasons and thought processes in addition to relying on a third party which might not be a reasonable excuse.

N Barrett v HMRC TC4514

Omitted pension – What is appropriate penalty?

Summary – The Tribunal determined the appropriate penalty for pension income omitted from a tax return

The taxpayer retired in 2013 aged 55. He started to receive a pension. In 2012/13 the pension was £8,468 and tax of £2,613.16 was deducted at source. He started his own business and filed a 2012/13 self-assessment tax return in December 2013. Unfortunately, he did not complete boxes 10 or 11 requiring pension income and tax deducted.

In September 2014 HMRC opened an enquiry into the return and calculated that additional income tax of £1,775 was due — this was mainly because his annual income exceeded the threshold of £100,000 and therefore part of his personal allowances were lost.

HMRC charged a penalty of £266.34 under FA 2008, Sch 24. The taxpayer appealed. He argued that, although he had completed tax returns for many years, he had made a mistake in not declaring the pension income because this was the first year in which it was received. Additionally, as he had already paid tax on it, he thought there was no need to declare this source on the form. For this and other reasons he felt that the penalty was harsh and that £25 would be reasonable.

Decision:

The First-tier Tribunal agreed that the return contained an inaccuracy and went on to consider whether this was as a result of carelessness. The tribunal felt that a careful read of the return and the accompanying notes would have made it clear that the pension must be declared. Therefore in the circumstances he had been careless.

The tribunal was satisfied that the penalty had been correctly calculated. It was 15% of the lost revenue, which took account of the maximum discount that could be given for prompted disclosure.

HMRC had considered whether there were any special circumstances and found none. The tribunal agreed and thus had no further jurisdiction to reduce the penalty.

Finally, the tribunal considered HMRC's decision not to suspend the penalty.

It considered the principles derived from previous tribunal decisions:

- The purpose of suspension was to educate traders who have acted carelessly in the past and prevent such behaviour in the future (*Shelfside (Holdings) Ltd* (TC1978)).
- If the only conditions that could be imposed were unlikely to have the above effect HMRC could not suspend the penalty (*Fane* (TC1075)).
- Generally, penalties for "one-off" inaccuracies should not be suspended because this would discourage a taxpayer from avoiding penalties in future (*Fane* and *Durrant* (TC3640)).
- The conditions for suspension must be more than an obligation to avoid making further returns containing careless inaccuracies (*Fane*).

In the circumstances, the First-tier Tribunal agreed that HMRC were correct not to suspend penalties. This was an isolated error and it was reasonable for HMRC to conclude that there were no conditions that would help the appellant avoid future penalties.

The appeal was dismissed.

Comments – This is additionally a good case to note because of the rationale of the decision. It is also useful for the reminder of the other case decisions listed in the judge's comments.

A Havercroft v HMRC TC4571.

No penalties before incorporation as determination of the taxpayer is important

Summary – The Tribunal held that penalties before incorporation should be set aside.

AEI was incorporated in the Bahamas and registered for VAT in the UK. In 2010, the taxpayer told HMRC that the company had been renamed AEI Group. It later transpired that the AEI Group was located in Belize and was a different company from AEI. The taxpayer, who was agent for both companies, said AEI had ceased in 2010 and its business was carried on by AEI Group from the date it was incorporated — 4 January 2010.

In 2012, HMRC issued notices to file tax returns for the periods ended 31 January 2007 to 31 January 2012 to AEI Group to the Bahamas address. Later, HMRC became concerned that the company might not have been resident in the UK but instead might have been trading in the UK through a permanent establishment. They opened a corporation tax record for the taxpayer as agent of AEI and issued notices to file corporation tax returns.

No tax returns were submitted, so HMRC imposed penalties under FA 1998, Sch 18 para 17 and para 18 against the taxpayer acting as agent for AEI Group and AEI Group for failure to deliver company tax returns. The taxpayer and AEI Group appealed.

Decision:

The First-tier Tribunal said HMRC were entitled to require a return to be made for periods when they had insufficient information to determine whether a company had a tax liability. However, the penalties could not apply to a company that was not incorporated. Therefore the notices for periods ending before 4 January 2010 should be set aside.

The taxpayers argued that they had a reasonable excuse for failure to file returns because HMRC had agreed that they could not be sent until the identity of the correct taxpayer was resolved. In addition, HMRC had failed to decide whether AEI Group or Mr Fulbrook **as** agent should submit returns.

The First-tier Tribunal said HMRC's failure to agree the tax position in advance could not amount to a reasonable excuse for not submitting returns. Nor was it unreasonable for HMRC to issue returns to several possible taxpayers when it was unclear who the correct taxpayer was.

The tribunal set aside the penalty determinations raised on the taxpayers for the periods before AEI Group was incorporated, reduced some of the flat rate penalties and confirmed others.

The taxpayers' appeal was allowed in part.

Comments – This case is a classic example of the confusion with organisations with similar names and particularly when they are in different jurisdictions. The taxpayer succeeded in part but not on their main argument of reasonable excuse.

C Fulbrook as agent for AEI Group Ltd and AEI Group Ltd v HMRC TC4483

Special relief agreed because of vulnerability of taxpayer

Summary – The Tribunal found completely on behalf of the taxpayer whose treatment by HMRC had been terrible in the circumstances.

HMRC raised assessments on the taxpayer for the six years from 2002/03 resulting in a total tax liability of £17,780.

The taxpayer appealed. The issue for the First-tier Tribunal was whether it was “unconscionable” for the Revenue to seek payment of the tax, given the circumstances of the taxpayer.

The taxpayer, who was dyslexic and had serious learning difficulties, said his wife dealt with correspondence. She registered him as a self-employed painter and decorator in 2003. He worked about three days a week but ceased in March 2004 and restarted in 2013.

In the intervening years he occasionally worked as an employee. The taxpayer and his wife separated in 2003 and she died in 2013. In 2006, there was a fire at his house and he could not return to live there for a year.

He had tried to deal with his tax affairs, but without success. HMRC asserted that he had made a conscious decision not to pay tax. Had he submitted the returns for the years, the assessments would have been set aside.

Decision:

The First-tier Tribunal found the taxpayer to be “frank, candid and utterly lacking in guile”. The judge said HMRC's response to the taxpayer's request for special relief (TMA 1970, Sch 1AB para 3A(4)) was “too narrow, inadequate, and lacking in consideration of the appellant's peculiar vulnerability. It ignores his inability to engage fully and satisfactorily with the tax authorities. It neither recognises nor makes any concession to his vulnerability.”

The taxpayer had not recognised the urgency of the matter. Even though there was an occasion when the taxpayer went to HMRC and the tax officer had to spell out the words for the response, they seemed unaware of the taxpayer's circumstances.

The judge said HMRC's refusal to allow special relief was “unreasonable” and that pursuit of the tax was “unconscionable”.

The taxpayer's appeal was allowed.

Comments – This case demonstrates the importance of having the Tribunal system so that fairness and justice can apply rather than the shabby treatment by HMRC on a vulnerable taxpayer. It would be hoped that HMRC take the comments of this case on board.

J Clark v HMRC TC4509

Penalties not unfair, disproportionate or unduly onerous

Summary – The Tribunal found in favour of HMRC that the penalties were in order.

HMRC imposed penalties of £3,632 on the taxpayer for late PAYE payments in the year ended 5 April 2011.

The company appealed. While acknowledging that penalties of £969 were due, the company said some payments that HMRC claimed were late were paid on time. The company also said that HMRC had allocated some payments incorrectly. It argued further that the penalties were “unfair, disproportionate or unduly onerous”.

Decision:

The First-tier Tribunal stated that, following the Upper Tribunal's decision in *Hok v CRC* it had no power to cancel the penalty on grounds that it was unfair. The judge had sympathy for the taxpayer's argument that the penalty was disproportionate and onerous, but was similarly bound by *Hok* and had no jurisdiction to set it aside for those reasons.

On the allocation argument, the judge said he accepted HMRC's mode of allocation. This was because, in some cases, the taxpayer had not requested payment be allocated to particular months. In others, it only did so after having received the penalty, by which time it was too late.

The company said that another cause of a payment being late was because HMRC did not use the faster payments system. It believed a payment it had made electronically would have arrived in HMRC's account the next day. However, it took three. The tribunal decided that because the taxpayer had not checked how long it would take for the payment to arrive, this did not amount to a reasonable excuse.

Finally, the tribunal agreed with HMRC that there were no special circumstances to merit reducing the penalty.

The taxpayer's appeal was dismissed.

Comments – This case demonstrates how if the penalty system is not understood by taxpayers a penalty can arise which the Tribunal is not able to change because of the parameters of the system.

Optrak Distribution Software Ltd v HMRC TC4471

Late-filing penalties quashed as income below PA so no SATR due

Summary – The Tribunal quite rightly quashed penalties in circumstances where HMRC should not really have raised penalties

In October 2014, HMRC imposed late filing penalties of £900 for the taxpayer's 2012/13 return which they said should have been submitted by 31 January 2014. The taxpayer appealed, saying the letter telling her about the penalties was the first time she had heard that the return was required. She had completed a return for 2013/14 because HMRC had asked her to do so.

Decision:

The First-tier Tribunal said, although it is the responsibility of the taxpayer to submit a return, someone can "only declare that which he or she knows or believes ought to be declared. If the state of mind of the appellant is that there is nothing to declare that can in appropriate circumstances amount to a reasonable excuse".

In this instance, the taxpayer knew her income was within the personal allowance so no tax was due, and this was shown in her 2012/13 return when she submitted in October 2014.

The taxpayer's appeal was allowed.

Comments –The main comment is that thankfully common sense prevailed.

Z Brennan v HMRC TC4497

Careless HMRC official not taxpayer

Summary – The Tribunal held in unusual circumstances that the taxpayer was not guilty of careless behaviour but that the HMRC official who helped had been careless.

The taxpayer and his wife formed a partnership in November 2009. The partnership made a loss in 2009/10 which was allocated to the wife. The following year, the partnership made a profit. This profit was included in the taxpayer's 2010/11 return, which also included a claim for partnership losses from 2009/10. After the enquiry period closed, HMRC discovered that the loss claim was incorrect and issued a discovery assessment.

The taxpayer appealed. He said the returns for 2009/10 and 2010/11 had been completed by a Revenue officer at a meeting with the taxpayer. He had provided information, answered questions, and signed the returns. He said that at no point had the officer explained that he was responsible for the return. HMRC said he had been careless in signing the return as complete and correct.

Decision:

The First-tier Tribunal did not consider the taxpayer had been careless. He had taken "the best route he knew of to make an accurate tax return". It would not be sensible to expect taxpayers to "be suspicious when dealing with HMRC". In this instance, the HMRC officer was the careless individual.

On whether an officer could act on behalf of the taxpayer, the tribunal said not and nor had he in this case. An employee of HMRC could not act on behalf of someone in a transaction with HMRC. However, the tribunal said the taxpayer viewed the service as offered by HMRC rather than a particular person.

Allowing the taxpayer's appeal, the tribunal added:

"We wish to make it very clear that the facts in this case are extremely unusual. We are unable to be sure they are unique because this 'service' was offered in this office for several years and by more than one person. However, they may well be unique in their particulars. We therefore wish to make it clear that this case turns on its facts, and even small differences in those facts may have led to a different conclusion."

Comments – The comments of the Tribunal judge are self-explanatory

K Jaynes v HMRC TC4410

Lack of evidence is not an inaccuracy

Summary - The FTT found that a claim under the VAT DIY *scheme had not been inaccurate.*

HMRC had imposed a penalty for inaccuracy of a claim under s 35 VATA 1994, on the basis that the taxpayers had not provided evidence that the building had remained unoccupied over a ten year period. In the alternative, HMRC also claimed that by answering 'yes' to the question of whether they held evidence of ten years of non-residential occupation (question 11), the taxpayers had made their claim form inaccurate.

Decision:

The FTT pointed out that this failure may justify a finding that the taxpayers had not taken reasonable care, but it did not make the claim form they had completed inaccurate.

The FTT pointed out, however, that nothing in the form or the guidance notes suggested that the claimants must have, and retain, documentary proof of ten years' non-occupation. The FTT added that if the form had contained an inaccuracy, HMRC had not established that it had been careless. Looked at objectively, the conduct of Mrs and Mr Howells had been capable of being careless; however, it was also explicable that the appellants had read the questions and notes in the same way as the FTT, or that they had misunderstood them, which was not careless conduct.

Comments - This case confirms that the taxpayers' inability to provide the information that was required by HMRC to support their claim did not make them liable to a penalty.

Mrs and Mr Howells v HMRC [2015] UKFTT 412

Whether the notification of an assessment was valid as details were missing

Summary - The FTT found that an assessment was valid, even though it did not state the period to which it related explicitly.

The school (LSE) applied for the recovery of an amount of money repaid to it by HMRC representing incurred VAT against an assessment for period '00/00' in the sum of £1,442,597. Was the notification of the assessment — comprising three items: VAT form 655, a letter from HMRC dated 4 September 2012 and a letter from HMRC dated 9 September 2010 (to which the September 2012 letter referred) — valid? This depended on establishing the correct prescribed accounting period for the purposes of an assessment made under VATA 1994 s 73(2); and deciding whether an assessment specifying a date which fell within a prescribed accounting period (rather than specifying a prescribed accounting period) was sufficient to make the notification of the assessment valid.

Decision:

The FTT found that the decision in *DFS* [2004] STC 559 was binding, so that 'prescribed accounting period' in s 73(2) referred to the prescribed accounting period in which the repayment had taken place.

Furthermore, s 73(2) must be interpreted with common sense and in line with what parliament had intended. If the prescribed accounting period to which the notification of assessment related could be deduced from the information provided in the notification, the notification was valid even though the start date and end date of the prescribed accounting period were not explicitly stated.

Comments - The FTT commented that if a notification of assessment was technically deficient, it was not a notification even if the appellant knew exactly to what the 'assessment' related. However, common sense must be applied to the question of whether a notification was valid. In the current situation the notification contained all the information required (although some of it had to be deduced); and the notification was therefore valid.

London School of Economics and Political Science v HMRC [2015] UKFTT 291

Partner payment notices were validly issued

Summary - The High Court determined that partner payment notices (PPNs) had been validly issued by HMRC.

The 154 claimants in this case had all participated in the Ingenious Media schemes designed to generate tax losses. Their substantive appeals were being litigated in the FTT and HMRC has issued PPNs (under FA 2014). The taxpayers asserted that the PPNs were not lawful and therefore of no effect for the following reasons:

- The statutory scheme was unfair, as the claimants had not been given the opportunity to make representations as to why the sums demanded under the notices were not due and owing.
- The notices were ultra vires because Condition B (in s 219) was not satisfied. The amounts claimed were shares of losses. They did not result directly from an increase or reduction of an item in the partnership return.
- The notices had been given in breach of the claimants' legitimate expectations that they would not have to pay any tax in dispute until after the FTT had decided all of the relevant issues.
- The decision to give notices was irrational, as HMRC had not properly exercised its discretion.
- The issue of the notices had been in breach of the European Convention for the Protection of Human Rights (ECHR) art 1 of the First Protocol (right to protection of property) (A1P1) and art 6 (right to a fair trial).

Decision:

The High Court found that the statutory scheme was not unfair, since the circumstances created by the PPN were only temporary. Furthermore, recipients of PPNs were afforded the opportunity to make representations. However, such representations could not extend to the merits of the substantive appeal as contended by the appellants.

The High Court also found that the PPN scheme operated regardless of the mechanics of the tax advantage. The offset loss claimed by the taxpayers therefore fell within the scope of the legislation.

Also, no legitimate expectation was established, in the absence of a well-recognised practice by HMRC of making 'carry back' repayments. In any event, the new provisions expressly removed pre-existing rights.

The ground that HMRC's decision had been irrational also failed, on the basis that 'there is nothing wrong with a general rule that when the statutory criteria are met, the discretion will be exercised by issuing the notice, save in exceptional circumstances'. Furthermore, the requirement to pay tax which had been avoided for ten years through the implementation of a scheme did not amount to 'significant human suffering'.

Finally, the taxpayers' claim under their substantive appeal was not a property right for the purpose of ECHR; and art 6 did not apply when the state determined a person's liability to pay tax.

Comments - The taxpayers' arguments essentially challenged the legality of the advance payment statutory scheme itself. It would be highly unlikely that a Court would find that. They were robustly rejected by a High Court, which reiterated the notion that taxpayers who engage in tax planning should make provision for the eventuality that the tax may become payable.

Nigel Rowe and others v HMRC [2015] EWHC 2293

Use of the capital loss and judicial review

Summary - The UT rejected an application for judicial review of a demand for payment of tax.

In 2009/10, the taxpayer had taxable income of £519,625. In his return for the year, which he submitted online in January 2011, he claimed relief under ITA 2007, part 4 chapter 6 (s 131 et seq) for a capital loss of £414,500. This resulted from a purchase of 500,000 shares in a company for £500,000, which the taxpayer sold for £85,500 in 2010/11. In October 2011, the Revenue made a payment of £70,497.90 to the taxpayer.

However, HMRC decided to investigate the loss, saying the taxpayer had to prove it was not a result of arrangements to secure a tax advantage. They claimed further that, even if the loss were allowable, the taxpayer would not be entitled to carry it back (TMA 1970, s 42 and Sch 1B). They opened an enquiry on 4 January 2012 into the 2009/10 return and, in June 2014, issued a demand for £95,546.36, replacing a previous one for £166,044.

The taxpayer claimed that the enquiry had no effect. The only enquiry that could have been opened into the return was one under TMA 1970, s 9A, but HMRC had not done so and it was now too late. He sought judicial review of the tax demand before the Upper Tribunal.

Decision:

Mr Justice Morgan in the Upper Tribunal said the taxpayer's claim to relief under ITA 2007, part 4 chapter 6 was subject to the provisions of TMA 1970, s 42 of the 1970 “procedure for making claims etc”, in particular Sch 1B(2) “loss relief”.

It was clear from the calculation pages of the taxpayer's 2009/10 return that his tax liability was £95,546.36. It was also clear that he wished to claim relief for capital losses. The judge said the claim related to 2010/11 and did not reduce the tax payable for 2009/10.

Referring to *Cotter v CRC* [2013] STC 2480, the judge said TMA 1970, s 42(11) gives effect to Sch 1A (claims not included in returns) and therefore HMRC were permitted to open an enquiry under Sch 1A into the taxpayer's loss relief. Disregarding the payment of £70,497.90 made to the taxpayer, he was liable to tax of £95,546.36 on 31 January 2011.

Finally, the judge said judicial review had not been the appropriate way to proceed but, having heard the arguments, he would grant declarations to give effect to what had been decided. The tax due for 2009/10 was £95,546.36, subject to arguments on the £70,497.90 paid to the taxpayer.

Comments - The UT pointed out that the service of a demand did not create a liability in the absence of tax due. Mr Derry should therefore have waited to be sued in the County Court or the High Court. He could also have sought declaratory relief in advance of being sued.

R (on the application of Derry) v CRC, Upper Tribunal

The jurisdiction of the FTT over special relief

Summary - The FTT found that HMRC's decision not to allow special relief had been unreasonable.

Under TMA 1970 special relief provisions, HMRC can allow a claim for relief of overpaid tax when more than four years have elapsed since the end of the relevant tax year. The first condition is that it would be unconscionable for HMRC to seek to recover the amount.

The taxpayer, Mr Scott, had made a formal request for special relief, explaining that the returns were late 'due to the serious sickness over a prolonged period and subsequent death of his previous accountant'. Mr Scott contended as well that the determinations by HMRC had been excessive. HMRC had refused the claim for special relief, on the basis that Mr Scott had previously been non-compliant in submitting tax returns.

Decision:

The FTT noted that 'the disparity between the sums determined and the sums due, as put to HMRC, was so striking that some further explanation and inquiry were called for'. By not considering the disparity, HMRC had failed to take account of a material factor which was relevant to the issue of unconscionability. Additionally, HMRC had taken an irrelevant factor into account. Mr Scott's tax history was irrelevant. HMRC's decision was therefore not rational.

Comments - Following *Currie* [2014] UKFTT 882, the FTT determined whether HMRC's opinion on conscionability had been 'unreasonable' in the judicial review sense, without substituting its own view.

James Ronaldson Scott v HMRC [2015] UKFTT 420

Suspended penalty decision by FTT

Summary – The FTT recognised that the taxpayer's view was completely incorrect but suspended the penalty conditionally.

In his tax returns, the taxpayer, a self-employed locum pharmacist, claimed interest on a loan used to buy guaranteed equity bonds to fund his pension. He also claimed a deduction for the cost of acquiring the bonds. HMRC refused the claims and also imposed a penalty for careless behaviour under FA 2007, Sch 24.

The taxpayer appealed, saying the bonds were to form a self-invested personal pension (SIPP) and the expenditure should be allowed against his trading income.

Decision:

The First-tier Tribunal stated "on no basis" could the taxpayer's arrangements be called a SIPP. He was "just saving for his retirement". The bonds were not a contribution to an approved pension scheme and the taxpayer was not entitled to a deduction for their purchase. Similarly, the loan taken out to finance the bonds was not wholly and exclusively for the purposes of his trade and it followed that neither was the interest. No deduction was permitted.

On the penalty, the tribunal said the errors were due to the taxpayer's "careless and negligent misunderstanding of the way in which businesses undertaken by individuals and companies are taxed". Had he taken advice, the error may not have arisen.

However, the tribunal said the penalty should be suspended for two years as long as the taxpayer appointed a professional adviser and filed future returns accurately and on time.

The taxpayer's appeal was allowed in part.

Comments – The taxpayer's view was one which was completely unsustainable but the taxpayer was lucky to have the penalty suspended on the basis that he appointed an adviser (who would understand the tax system).

B Patel v HMRC TC4617

Late applications refused

The following reports concern late appeals by the taxpayers, each of which was refused by the First-tier Tribunal.

No co-operation by taxpayers

The taxpayers, a father and son, were taxi drivers. In July 2012, HMRC opened enquiries into their self-assessment tax returns. In January 2013, HMRC issued a closure notice with discovery assessments and penalties. The taxpayers' representative wrote to HMRC saying his clients wanted to appeal but were not ready to say on what grounds. No information was sent to HMRC, so they proceeded with collection. In October 2014, the taxpayers applied to make a late appeal.

The First-tier Tribunal refused the application. The judge said the taxpayers had “notably failed to co-operate with HMRC's enquiries” over nearly four years. They took action only when the sheriff officers arrived at their door to collect the tax. Although they claimed to have relied on their adviser, HMRC had repeatedly written directly to them, requesting more information.

The tribunal concluded that it would be “wholly inappropriate” to allow the applications.

S Smith and G Smith v HMRC TC4535

Inordinate delay by taxpayers

The Revenue imposed penalties of £1,200 on the taxpayer for the late submission of its 2009/10 employer return P35. The business lodged a late appeal in February 2015. Mr E, one of the partners who ran the business, which ceased in 2012, said that the other partner had been responsible for the financial affairs of the company but he was untraceable. When he realised the return was outstanding, Mr E took action to settle matters.

The First-tier Tribunal said the grounds for the appeal did not constitute reasonable excuse.

All partners bore a shared responsibility for tax obligations of the business. The delay in appealing was “inordinate”. Although Mr E might have “right of relief against his former partner … he has no defence to the imposition of theses penalties”.

The taxpayer's application for a late appeal was refused.

Camping-on-Tyne v HMRC TC4543

Unconvinced by taxpayer’s argument re delay

The First-tier Tribunal concluded that there was no reason to accept a business's late appeal against penalties of £2,700 for late payment. The taxpayer failed to lodge an appeal until more than a year after the penalty notice. The only explanation offered for the delay was that the director of the taxpayer had been “too busy” with other problems.

The judge said it was for the taxpayer to show why the appeal should be heard out of time. In this instance, the taxpayer's main case was that it suffered an insufficiency of funds. No evidence was provided that this was the result of circumstances that were unforeseeable and outside the control of the business. The tribunal concluded that the grounds of appeal were not convincing and did not support an extension of time within which to bring an appeal.

The taxpayer's appeal was dismissed.

Luddington Golf Club Ltd v HMRC TC4545

Auto enrolment – current tasks Autumn 2015 (Lecture B918 – 8.31 minutes)

Financial advice?

Helping a client to choose the right pension product for his business and workers **does not** come within the definition of financial advice, as FCA regulation covers only advice to individuals. However, the liability issues associated with helping a client to choose a pension scheme are very significant indeed, and most firms will not wish to advise outside their competence. If this is your firm's decision, you will need the services of an IFA.

One of the early decisions to take is whether your firm will provide advice about an appropriate product, or will link with an IFA to provides a seamless service to your clients, or whether you will ask clients to source their own financial adviser. In deciding whether to undertake financial advice about pension arrangements you will need to check whether your PII cover extends to giving advice of this nature, and also whether you believe that you have staff with the required skills and training to deliver such advice.

If you are linking with an IFA, your firm will need to contact the financial adviser early to agree how much lead time they will need to dovetail advice about appropriate schemes into the whole preparation plan. The IFA will also be able to advise how much notice the various pension providers may need to implement a scheme. Current estimates are around six months, so those clients staging early in 2015 will need to start making preparations in the autumn of 2014.

You should also be aware that some pension providers are not prepared to deal with much smaller schemes, with one provider limiting business to schemes generating £6,000 per month in contributions, and others unwilling to accept business below £2,000 per month in contributions. At the level of contributions required initially, this equates to gross pay in the payroll of between £100,000 and £300,000 per month.

Workload volumes

The Pensions Regulator has published data to indicate how many employers in the medium sized down to micro categories will be staging over 2015 to 2018. The latest information (based on data provided by HMRC regarding employer numbers on 1 April 2012) is as follows.

Employer size	Quarter (financial year)	Forecast volumes
Medium employers, 50-249 people	Q1 2014/15	15,900
	Q2 2014/15	11,500
	Q3 2014/15	1,200
	Q4 2014/15	3,400

Small and micro employers, fewer than 50 people	Q1 2015/16	17,100
	Q2 2015/16	9,700
	Q3 2015/16	16,100
	Q4 2015/16	110,000
	Q1 2016/17	101,000
	Q2 2016/17	133,000
	Q3 2016/17	168,000
	Q4 2016/17	215,000
New employers	Q1 2017/18	178,000
	Q2 2017/18	137,000
	Q3 2017/18	131,000
	Q4 2017/18	87,000
Total		1,334,900

Nominate a contact

Once an employer is within 12 months of their staging date, they will receive a letter from the Pension Regulator advising them to commence preparations. There will be a reference on this letter and employers can then nominate the contact for the Pensions Regulator.

Nominating a contact early means that the contact will receive emails periodically from the Regulator, advising them of the necessary state of preparations, and the next jobs they should be starting.

The link for nominating a contact is

https://forms.thepensionsregulator.gov.uk/workplacepensionsreform/nominate.aspx

The employer is required to name the **primary contact.** This must be the most senior person within the employing organisation, for instance, CEO, managing director etc. This person will receive letters and also emails if no secondary contact is provided.

It is also possible to nominate a **Secondary contact.** This is the person who will manage or implement enrolment, for instance, HR manager, pensions manager, accountant, IFS etc. This person will receive emails to help with the implementation, and will therefore be reminded of what needs doing and when. External professional advisers may decide to nominate a member of their auto enrolment staff as the secondary contact so that they can keep track of the various employer responsibilities.

Key action points

- Decide who within your firm will take responsibility for scheduling work on auto enrolment for the clients you are acting for
- Decide whether a member of your firm's staff will be the secondary contact for some or all clients and advise clients accordingly, gathering contact details for clients (primary and optionally secondary) early, but not before 12 month point.

Planning the assessment process

Strictly, assessment of workers is done at the staging date (or the deferral date if auto enrolment is postponed for some or all employees). However, the early planning can identify a suitable advance date to carry out a preliminary assessment, which can be reviewed as the staging date approaches.

Director only companies

Recent guidance issued by ICAEW clarifies the position with regard to director only companies. Provided either none of the directors, or only one of them has an employment contract there is no auto enrolment responsibility on the company.

One of your areas of preparation, therefore is to ensure that these are notified to The Pensions Regulator to ensure that no further communications are received in respect of these companies. You do not need to apply for the exemption unless your client receives a letter from the Pensions Regulator (TPR) informing them of their staging date. In these circumstances, you should email customersupport@autoenrol.tpr.gov.uk and complete the details in the pre-populated message that opens when you select that email address.

If your computer doesn't automatically open the message in the email service you use, you can download it and follow the instructions at
http://www.thepensionsregulator.gov.uk/docs/No_employer__duties_template_email.pdf

If the company's circumstances change so that automatic enrolment duties apply the company (or you as their agent) will need to inform TPR of this as soon as possible. For example, if the company takes on a member of staff other than a director, or if at least two directors start working under contracts of employment.

When to assess your workers

Workers must be assessed at various points in the run up to and during auto enrolment. An early review allows the employer to plan for the number of active members of the scheme and discuss with the pensions provider in detail. The Table below outlines the broad rules:

Annual earnings (2014-2015)	Age		
	16-21	**22-state pension age**	**State pension age -74**
Less than £5,772	Has a right to join a pension scheme (referred to as "entitled worker")		
£5,773 to £10,000	Has a right to opt in (referred to as a "non-eligible jobholder")		
Over £10,000	Has a right to opt in	Automatically enrol*	Has a right to opt in

Contributed by Rebecca Benneyworth

Auto enrolment – The importance of postponement (Lecture B919 – 9.40 minutes)

The main staging dates for employers are determined by reference to the number of employees in the PAYE scheme as at 1 April 2012.

Employers who registered their PAYE scheme after that count as new employers and will not stage until May 2017 at the earliest.

Table 1: List of staging dates by PAYE scheme size or reference; employee numbers as at 1 April 2012

PAYE scheme size or reference	Staging date
30-39	1 October 2015
Fewer than 30 with the last 2 characters in their PAYE reference numbers	
92, A1-A9, B1-B9, AA-AZ, BA-BW, M1-M9, MA-MZ, Z1-Z9, ZA-ZZ , 0A-0Z, 1A-1Z or 2A-2Z	1 June 2015
BX	1 July 2015
BY	1 September 2015
BZ	1 November 2015
02-04, C1-C9, D1-D9, CA-CZ or DA-DZ	1 January 2016

00 05-07, E1-E9 or EA-EZ	1 February 2016
01, 08-11, F1-F9, G1-G9, FA-FZ or GA-GZ	1 March 2016
12-16, 3A-3Z, H1-H9 or HA-HZ	1 April 2016
I1-I9 or IA-IZ	1 May 2016
17-22, 4A-4Z, J1-J9 or JA-JZ	1 June 2016
23-29, 5A-5Z, K1-K9 or KA-KZ	1 July 2016
30-37, 6A-6Z, L1-L9 or LA-LZ	1 August 2016
N1-N9 or NA-NZ	1 September 2016
38-46, 7A-7Z, O1-O9 or OA-OZ	1 October 2016
47-57, 8A-8Z, Q1-Q9, R1-R9, S1-S9, T1-T9, QA-QZ, RA-RZ, SA-SZ or TA-TZ	1 November 2016
58-69, 9A-9Z, U1-U9, V1-V9, W1-W9, UA-UZ, VA-VZ or WA-WZ	1 January 2017
70-83, X1-X9, Y1-Y9, XA-XZ or YA-YZ	1 February 2017
P1-P9 or PA-PZ	1 March 2017
84-91, 93-99	1 April 2017
Fewer than 30 unless otherwise described	1 April 2017
Employer who does not have a PAYE scheme	1 April 2017

Table 2 : Staging dates for employers who started their PAYE scheme after 1 April 2012

Date PAYE income first payable	Staging date
Between 1 April 2012 and 31 March 2013	1 May 2017
Between 1 April 2013 and 31 March 2014	1 July 2017
Between 1 April 2014 and 31 March 2015	1 August 2017
Between 1 April 2015 and 31 December 2015	1 October 2017
Between 1 January 2016 and 30 September 2016	1 November 2017
Between 1 October 2016 and 30 June 2017	1 January 2018
Between 1 July 2017 and 30 September 2017	1 February 2018

Staging date tool

If employers are not sure of their staging date, the Pensions Regulator site provides a staging date look up tool at

http://www.thepensionsregulator.gov.uk/employers/tools/staging-date.aspx

Bringing forward a staging date

If an employer wishes to bring forward their staging date to tie in with a financial year end or for other reasons, this can be done online, through the same portal as is used for registration with the Pensions Regulator. However, the employer must select one of the available staging dates, and not all dates are available.

Conditions for bringing the staging date forward

To bring the staging date forward, the employer must:

- have an existing staging date.
- have contacted a pension scheme that can be used to comply with the employer duties and secured the agreement of the trustees or managers, provider, or administrator of the scheme, that the scheme will be used to comply with those duties from the new (earlier) staging date.

- notify The Pensions Regulator in writing (online, or by letter, fax or email) at least one calendar month before the new (earlier) staging date providing the following information:
  - Employer name.
  - Employer PAYE scheme reference(s) e.g. 123/4AB.
  - The new (earlier) staging date chosen and the original staging date.
  - Employer's address (including postcode) and email address.
  - The name of the owner or most senior accountable person at the employer (optional).
  - Companies House registration number or equivalent, e.g. registered charity number, VAT registration number or industrial provident society number.
  - A declaration from the employer that they have contacted a pension scheme and have obtained the agreement of the trustees or managers, provider, or administrator, that the scheme can be used to comply with the employer duties from the new (earlier) staging date.
  - Your name (applicant), job title within the organisation and contact telephone number, email address and business address.
  - A declaration that the applicant is authorised to apply for a change of staging date.

Available dates

The dates which can be selected are:

2015	2016	2017
1 September	1 January	1 January
1 October	1 February	1 February
1 November	1 March	1 March
	1 April	1 April
	1 May	1 May
	1 June	1 June
	1 July	1 July
	1 August	1 August
	1 September	1 September
	1 October	1 October
	1 November	1 November

Plus 1 January 2018.

Postponing auto enrolment

Employers are permitted to postpone auto enrolment start date by up to three months for some or all of their employees. However, this does not alter the employer staging date; it does delay the date that employees are actually enrolled in a scheme. Postponement can be used after staging to delay enrolling staff in a scheme who are going to leave the employment in under three months.

Dates from which the employer can use postponement

The employer is only permitted to postpone auto enrolment with effect from certain dates. These are :

- The staging date
- A staff member's first day of employment
- The date a staff member first becomes eligible for automatic enrolment.

How to postpone

The employer must write to tell the staff whose automatic enrolment has been postponed, within six weeks from the date postponement starts. It is possible to postpone only for selected staff, and it is acceptable to have different postponement periods for different staff. The Pensions Regulator provides a selection of standard letters to advise employees about postponement, and recommend the use of letter template 6 if the employer is postponing from the staging date.

http://www.thepensionsregulator.gov.uk/docs/Template_for_Letter_6_-_postponement_-_all_workers.doc

There is no need to inform the Pensions Regulator of postponement, but employer must be aware that postponing from the staging date does not alter the staging date.

What happens next?

Employees who have been postponed can opt into the pension scheme during the postponement period. If they give notice of opting in, the employer must enrol them in the scheme.

At the end of the postponement period the employer must enrol those employees who remain eligible for auto enrolment immediately. It is not possible to have a further postponement, even if the original postponement was for less than the three months permitted.

Further guidance on postponement

There is an A4 booklet (32 pages) giving more information for professional advisors. It is http://www.thepensionsregulator.gov.uk/docs/detailed-guidance-3a.pdf

Key action points

- As you assume responsibility for each client, it is worth discussing postponement in respect of seasonal staff. Arriving at a strategic decision for clients who take on extra staff on a seasonal basis may make auto enrolment much easier for those clients.
- Discuss with each client whether it is appropriate to bring forward a staging date to avoid staging at a particularly busy time for the business. For larger clients, bear in mind the time constraints associated with uploading data to pension provider systems around the staging date.
- Ensure that you have considered the staffing implications for your firm of clients staging at particularly busy times in the year, such as 1 February, when staff may be dealing with tax return clients in the run up to staging.

Contributed by Rebecca Benneyworth

Update on HMRC's Digital Strategy (Lecture P920 – 18.40 minutes)

What is their aim?

To do their job, HMRC need to interact with taxpayers. Historically this was achieved by face-to-face meetings and communicating by post and by phone. These methods require a lot of human interaction and are slow, which was frustrating for both taxpayer and HMRC staff alike.

Interacting online has become part of everyday life. Increasingly, HMRC have made use of emails and the Internet to supply and process information. Online tax returns and PAYE moving to a real time basis are both examples of HMRC making use of digital options. Their ultimate aim is for us to have just one efficient digital experience that frees up time to support those who need help more effectively. This will not be delivered as one big bang experience but rather piecemeal over time, being optimized by 2020.

If they get it right, everything will be held in one place, human interaction will be minimal and as much as possible will move to real time. We will have a fully automated tax system. In developing this system, there are certain things that HMRC must not overlook. The system must be 100% secure, taxpayers and their agents will need to be educated and HMRC will have an increased amount of compliance checking to ensure that people are providing accurate and timely information.

The digital tax account

Each taxpayer would have their own digital account with much of the information being pre-populated from other sources including:

- Business bank account
- Employer information
- Utility suppliers
- Passport Office
- Land registry

The taxpayer would login, check this pre- populated information to make sure that all income sources and expenses paid have been picked and then supply any additional information needed.

Speculation

So what might the self-employed pages look like? Here are a few ideas, they are not based on anything published by HMRC but are an illustration of how technology could be developed.

Question 1: How much did you receive from your customers last month?

£

Question 2: How much did you spend last month on materials and other business expenses *other than car journeys or use of your home?*

£

Could eventually be automated from bank account

Question 3: How many miles did you travel on business in your car last month?

£

Car details would be recorded as permanent information
Fixed rate deductions could easily be calculated

Question 4: How many hours did you work at home last month?

Less than 10

Between 10 and 40

More than 40

Keep it simple:
- Fixed rate deductions
- No need to apportion actual expenses/keep paperwork
- Use cash basis; ignore accruals

Question 5: Did you spend more than £500 on any one item last month – if so, give details

- *100% allowances for most capital expenditure*
- *Highlight high value items*
- *Ask for copy of receipt*

The system would automatically calculate the profit and show the tax payable, perhaps on a monthly basis so effectively moving the self employed to a PAYE type of system.

An output screen might be generated giving the taxpayer the option to pay their tax directly:

OUTPUT

Based on the information you have provided we estimate that your liability for this month is:

£ XXXXXXXXX

If you wish to pay this now, click **here** to make a payment by direct debit.

This could be introduced on a voluntary basis to start with, moving to a mandatory system at a later date.

Annual filing

If taxpayers move to a pay as you go system, would we still need an annual return? Our answer at this stage would instinctively be yes, but as digital systems become more sophisticated, our need for reconciliations and tax adjustments may well diminish.

Risk triggers

HMRC are very keen to develop risk triggers, either in their own, or in third party software so errors and problems can be picked up in real time. After all, it is much easier to remember something that had happened last month than something that happened 2 or 3 years ago.

HMRC will not necessarily take things at face value. It is their role to challenge where something is outside the norm.

The system could be designed to identify an entry that is outside the normal bounds of tolerance and prompts the taxpayer to check their input, highlighting that if they need to know more, HMRC will send the taxpayer an email to their online digital account.

So for example, returning to out self employed online pages:

Question 2: How much did you spend last month on materials and other business expenses *other than car journeys or use of your home?*

£ 50,000

Last month your expenses were £5,000?

Did you mean to insert £50,000?

If no, please amend

If yes, please explain in the box below

Certainty

What a lot of taxpayers want is certainty about their liabilities so it is important to appreciate that real time information can help taxpayers in this area. Provided that they have provided the right information, in the right form, and to the right level of accuracy, they would know what their liability was and HMRC would not be able to raise any questions about these items later unless, of course, it was due to dishonesty or fraud.

Deadline Dates

1 October 2015

- Due date of payment of corporation tax liabilities for periods ended 31 December 2014 for small and medium-sized companies not liable to pay in instalments.
- The date that the National minimum wage rates increase.

5 October 2015

- The date by which HMRC must be advised of income tax or CGT liabilities for 2014/15 if a tax return or notice to file has not been received.

7 October 2015

- The due date for VAT return and payment for 31 August 2015 quarter (electronic payment).

14 October 2015

- Form CT61 to be submitted and tax paid for quarter ended 30 September 2015 by this date.
- Due date for the quarterly corporation tax instalment for large companies depending on accounting year end.
- Due date for submission of Monthly EC sales list (paper return).

19 October 2015

- Pay PAYE/CIS liabilities by this date for month ended 5 October 2015 if by cheque.
- Payment of PAYE liability due for quarter ended 5 October 2015 if average monthly liability is less than £1,500.
- File monthly CIS return by this date.
- PAYE settlement agreement tax/Class 1B NIC liabilities to be paid by this date if paying by cheque.

21 October 2015

- File online monthly EC sales list by this date.
- Submit supplementary intrastat declarations for September 2015 by this date.

22 October 2015

- PAYE/National Insurance/student loan/CIS payments to be paid by this date if being paid online.
- Electronic payment of PAYE for quarter ended 5 October 2015 due if average monthly liability is less than £1,500.
- Electronic payment of PAYE settlement agreement liabilities due.

31 October 2015

- Deadline for the submission of 2014/15 paper self-assessment tax returns.
- Deadline for individuals with PAYE income to request a self-assessment tax return for 2011/12 under ITEPA 2003, s 711.
- Companies House should have received accounts of private companies with a 31 January 2015 year end by this date.
- Companies House should have received accounts of public limited companies with a 30 April 2015 year end by this date.
- HMRC should have received corporation tax self-assessment returns for companies with accounting periods ended 31 October 2014 by this date.

HMRC News

Autumn Statement 2015

The Chancellor of the Exchequer has announced that the Autumn Statement will take place jointly with the spending review on Wednesday 25 November 2015.

Finance (No. 2) Bill 2015

The Public Bill Committee will sit next on 13 October and will conclude on 20 October

SI 2015/1670 The Pensions Act 2014 (Commencement No. 6) Order 2015

This commencement order brings fully into force on 12 October 2015 provisions for the Class 3A voluntary NICs/state pension top-up scheme in Northern Ireland, allowing eligible individuals in Northern Ireland to pay a Class 3A contribution in return for a unit of additional state pension. For the rest of the UK, the scheme is brought into force by commencement order SI 2015/1475

Simplification of the tax and NI treatment of termination payments

The government is considering how they can make the tax and National Insurance contributions (NICs) treatment of termination payments simpler and fairer and wants to hear your views on how that can be achieved.

The consultation particularly seeks views on:

- removing the distinction between contractual and non-contractual termination payments and whether this will make it easier for employers and employees to understand
- the design of the new exemption from income tax and NICs
- whether the income tax and National Insurance treatment of termination payments should be aligned
- which of the existing exemptions which remove the liability to income tax should be retained and whether any new exemptions should be introduced

The Scottish Rate of Income Tax

The Scottish rate of Income Tax will start on 6 April 2016.

The Scottish rate of Income Tax was introduced in the Scotland Act 2012.

Depending on the level the Scottish Parliament sets the rate at Scottish taxpayers may pay a different rate of Income Tax to the rest of the UK.

Some of the Income Tax collected under the Scottish rate will fund the Scottish government and the rest will fund the UK government.

The Scottish rate of Income Tax doesn't apply to income from savings such as building society interest or income from dividends. This rate will stay the same for all taxpayers across the UK.

The Scottish government is expected to announce the proposed Scottish rate of Income Tax for the tax year 2016 to 2017 in its autumn 2015 draft budget.

HM Revenue and Customs (HMRC) will collect the Scottish rate of Income Tax on behalf of the Scottish government.

Identifying Scottish taxpayers

It's where you live, not where you work, that decides whether you're a Scottish taxpayer.

You'll pay the Scottish rate of Income Tax if:

- you're resident in the UK for tax purposes, and
- your main residence for most of the tax year has a Scottish postcode

HMRC will contact potential Scottish taxpayers before April 2016. If the address HMRC holds for you is in Scotland you'll be classed as a Scottish taxpayer. It's your responsibility (not your employers') to notify HMRC if you change your address.

Your April 2016 tax code will begin with the letter 'S' to show you're a Scottish taxpayer.

If you pay your Income Tax through your wages (known as Pay As You Earn)HMRC will advise your employer to treat you as a Scottish taxpayer so you don't need to do anything.

The Scotland Act 2012 contains the full definition of a Scottish taxpayer but where residency is not straightforward there are examples of 'close connection' that will help you.

National Insurance contributions are unaffected by the introduction of the Scottish rate of Income Tax.

Employers and Pension Providers

HMRC will identify Scottish taxpayers and tell employers the tax code to apply to their employees before the introduction of the Scottish rate of Income Tax. There will be no change to how employers report or make payments for Income Tax to HMRC other than to apply the Scottish rate of Income Tax code to their Scottish taxpayer employees.

HMRC will also provide this information to registered pension scheme administrators and pension providers to allow them to identify their Scottish taxpayer members.

Pension Relief at Source (RAS)

The UK government has agreed that registered pension scheme administrators and pension providers have until April 2018 to put in place the changes necessary to their IT systems that will allow them to claim Relief at Source (RAS) at the correct rate. Until then all RAS claims will be made at the UK basic rate.

The June 2015 edition of the Employer Bulletin contains more information on the Scottish rate of Income Tax.

Taxman brings in record £1 billion from avoidance crackdown

HMRC has collected £1 billion in tax payments from users of tax avoidance schemes as a result of the government's new rules to collect disputed tax upfront, the Financial Secretary to the Treasury, David Gauke, announced today.

The Government introduced Accelerated Payments last year to radically change the economics of avoidance. Under these rules, disputed tax is paid up front by avoidance scheme users.
Financial Secretary to the Treasury David Gauke said:

> The Government will not tolerate tax avoidance and Accelerated Payments has been a real game changer.
>
> It is no longer possible for these individuals to avoid tax and sit on the money while their affairs are investigated. This first £1bn received in Accelerated Payments shows that we are turning the tables on those looking to avoid paying their fair share.

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

> Tax avoiders are running out of options. People now have to pay upfront and dispute later. We are winning around 80% of avoidance cases that people litigate. And many more are settling before litigation.

More than 25,000 notices to pay disputed tax have been issued by HMRC since August 2014. By the end of 2016, HMRC expect to have completed issuing around 64,000 bringing forward £5.5 billion in payments for the Exchequer by March 2020.

Travel and subsistence discussion paper

Introduction

Following a consideration of these rules by the Office of Tax Simplification (OTS) as part of their review of employee benefits and expenses, the government announced at Budget 2014 that it would conduct a review of the tax rules for travel and subsistence (T&S).

This discussion paper:

- sets out the background to the review, including an overview of the current T&S rules
- sets out the case for change, including an outline of the issues identified
- outlines a potential framework for new rules that tackle the issues identified
- summarises key questions and issues we would like to test with interested stakeholders and sets out the next steps

This discussion paper sets out the principled case for change and does not include any firm proposals. Responses to this discussion document will inform the policy development process, and the detail of any proposed reform would be subject to full consultation at a later date.

The review also needs to be set in the context of the background of the wider economic situation. At a time when the country is working to pay down the deficit, the government believes the best way to support hard working people through the tax system is by prioritising tax cuts for the lowest paid, through increases in the income tax personal allowance.

The government therefore believes that any new set of rules that simplify the tax treatment of T&S expenses must not overall come at a cost to the exchequer. This means that any simplifications to the rules which make them more generous than the current rules must be balanced by restrictions elsewhere.

Case for change

The physical work environment and patterns of working have evolved since the rules last changed. Better technology enables people to work flexibly across different locations, at their home and while travelling. Many employees do not have a fixed desk at any particular workplace or at a particular geographical location. There has also been an increase in the number of people who have responsibility for a geographical area and, as a result, make regular visits to a number of different sites.

The OTS found that the current system is reasonably well understood by employers and works for the majority of employees – those who attend the same work place each day and make an occasional business trip. However, the OTS also found that complexities arose for some employees who travel frequently to perform their work duties.

In addition to the OTS's findings, during the first phase of the government's review officials have spoken to a cross section of employers about the current rules. These employers echoed the sentiment that although the rules work well for most employees, for a minority of employees the rules are difficult to understand and operate.

These initial conversations also provided a view of the difficulties being faced by employers under the current rules, and the questions the government would need to consider in any reform, which were again similar to the OTS's findings.

The main issues that the OTS review highlighted were:

- a lack of understanding over the level of attendance that constitutes 'regular attendance' and how that test fits with the other rules
- confusion around the definitions of permanent and temporary workplaces, particularly as these terms do not take their everyday meaning, making the distinction between them seem contrived and resulting in outcomes that look unfair to some workers (eg those employees who have a se-

ries of workplaces which most people would regard as being "temporary" under any ordinary use of the word)

- the fact that the '24 month rule' relies on the employee's intention rather than the amount of time actually spent at the location, making it difficult for an employer to judge when that employee's intention changed

- the fact that the current rules can mean that an employee ends up with more than one permanent workplace, even where their workplaces are a significant distance apart

- confusion around whether or not a journey is 'substantively the same' as ordinary commuting or private travel

- confusion around homeworking, and whether or when a home to workplace travel is a workplace to workplace journey rather than ordinary commuting

Potential ways forward

The government has kept in mind the fact that the current rules work well for most employees. Therefore it is not the intention to change the tax treatment of travel expenses for those employees with fairly straightforward working arrangements where the current rules are generally clear and easy for an employer to apply and give the outcome that most employees and employers would expect.

As set out previously, the government intends that this review will not change the outcome of the proposals on the restriction of T&S relief for employees working through employment intermediaries, but the resultant legislation will be considered as part of this wider review.

The government believes that the fundamental principle behind the current rules (that tax relief should be available for business travel but not for ordinary commuting) are correct, but recognises that for some employees the current rules do not reflect the modern workplace and can be complicated for employers to apply.

It has become clear during the first phase of this review that the question of whether a journey is business travel or ordinary commuting is complex, and any set of tests that uphold the principle of the current rules will have a degree of complexity. However, the government does believe that the current rules can be significantly improved to make them easier to understand and to apply in practice.

Principles

Taking all of these factors into consideration, the government has identified a number of principles that any new set of rules should try to uphold.

These principles are:

- that tax relief should continue to be available for business travel, but not for ordinary commuting
- any tests should be objective and based on measurable facts as far as possible – they should not rely on the intentions of the employee
- new rules should not be based on the concepts of 'permanent' and 'temporary' workplaces except and unless these terms carry their everyday meaning
- employees should not have their journeys to multiple locations or areas which are a significant distance apart all treated as being 'ordinary commuting'
- relief should not be available for subsistence where this is essentially akin to a private expense
- any changes should not come at an additional cost to the exchequer

Based on these principles a potential framework for a new set of rules has been developed, which is described below. The framework sets out the shape of a possible new set of rules, and asks a number of questions of employers and other interested stakeholders to inform the further development of these proposals.

Many of the tests in the framework are similar to the tests in the current rules, but are formed with a view to being more objective in order to try and make them easier to apply in practice and understand. Some of the new or restructured tests are also based on the recommendations that the OTS made on how the current rules might be re-written to remove some of the complexity in a targeted way.

Feedback from this discussion document will inform policy development and the intention is then to have a further consultation on the detail of the proposed new rules and then to finally consult on the details of draft legislation.

Proposed framework

The intention for the proposed new framework would be to broadly allow tax relief for three types of journeys:

- journeys made necessarily in the performance of the duties of the employment
- journeys to allow the employee to attend a location where their attendance at that location is a necessary part of their job, and the location is not the employee's "main base"
- journeys to the employee's main base where all bases of the employee are 'detached duty' locations

The intention would be for employees to consider these rules in order - they would not need to consider the later rules if they had already qualified for relief under one of the earlier rules.

For example, if an employee is travelling to a location other than their main base, they would not need to consider the 'detached duty' rule at all since they would have already qualified relief under the 'main base' rule.

The three parts of the framework are discussed in more detail in the discussion document.

Summary of discussion questions

Question 1: Do you agree that these are the main issues that cause employers difficulty under the current rules? Which rules create the most difficulties?

Question 2: Are there any additional issues with the current rules that are not summarised above?

Question 3: How widespread is the issue of employees having more than one permanent workplace? Are there any particular industries or roles where it is commonplace?

Question 4: Overall, do you agree that there is a good case for reforming some aspects of the tax rules for travel and subsistence expenses?

Question 5: Do you agree that these are the right principles on which to base a new set of rules? Bearing in mind the requirement that any changes should not come at a cost of the exchequer, are there any additional principles that the government should consider?

Question 6: Do you agree that this rule currently works well and should remain broadly unchanged?

Question 7: Do you agree that the concept of an employee's "main base" is a sensible basis for a new rule?

Question 8: Would a test based on the percentage of an employee's time spent at each location be workable for employers in practice? Would it be better than the more subjective tests in place at the moment?

Question 9: Do you agree that employees should be able to nominate which of their 'bases' is to be their 'main base'? Is there an alternative that the government should consider (eg the location where the employee spends the highest proportion of their time)?

Question 10: Do you agree that there is still a need for tax relief for travel to a work location that an employee attends on detached duty as part of an ongoing employment?

Question 11: Do you agree that basing the rule on the concept of "detached duty" rather than a "temporary workplace" will make it easier for employers to understand what journeys the rule is intended to give relief for?

Question 12: How long should an employee be able to attend a location before it ceases to be a detached duty location, and why?

Question 13: Do you agree that it is simpler for the rules to consider workplaces that are objectively close together as a single location, rather than the current test of a change in workplace being 'substantial'?

Question 14: What measure of workplaces being 'close together' would be easiest for employers to administer in practice? Are there any that would be particularly difficult for employers to operate?

Question 15: Do you agree that the tax rules should not provide an incentive or a disincentive for working from home?

Question 16: Do you agree that employees shouldn't be able to nominate their home as their 'main base' if they have another 'base' elsewhere?

Question 17: Do you agree that removing relief for day subsistence is fair?

Question 18: Are there any particular groups of employees that would be particularly disadvantaged by removing relief for day subsistence? Are such employees in particular industries and are they more likely to receive scale rate payments or be reimbursed for actual expenses?

Question 19: Are there any circumstances where employees would normally need to (rather than choose to) incur a significantly larger expense on their day subsistence than normal due to being on a business journey? Are such employees in particular industries and are they more likely to receive scale rate payments or be reimbursed for actual expenses?

Question 20: Would employers continue to pay day subsistence if relief were removed, and if so in what circumstances?

Question 21: Are there any other ways of balancing the cost of the most generous simplifications set out in the framework that the government should consider?

HMRC Practice announcement on Anson SC case

On 1 July 2015 the Supreme Court gave judgment in favour of Mr Anson in the case of George Anson v HMRC (2015) UKSC 44. This case concerns the application of the double taxation agreement with the US to payments received by Mr Anson from a US Limited Liability Company HarbourVest Partners LLC registered in the state of Delaware. Lord Reed delivered the unanimous judgment of the court and he made clear that he relied on the facts found by the FTT, in particular those regarding the rights of Mr Anson that arose from the Delaware LLC Act and LLC agreement.

The FTT made findings that the profits of the LLC did not belong to the LLC in the first instance but the members became automatically entitled to their share of the profits as the profits arose and before any distribution. The FTT also found that the interest of a member in the LLC was not similar to share capital.

HMRC has after careful consideration concluded that the decision is specific to the facts found in the case. This means that where US LLCs have been treated as companies within a group structure HMRC will continue to treat the US LLCs as companies, and where a US LLC has itself been treated as carrying on a trade or business, HMRC will continue to treat the US LLC as carrying on a trade or business.

HMRC also proposes to continue its existing approach to determining whether a US LLCshould be regarded as issuing share capital. Individuals claiming double tax relief and relying on the Anson v HMRC decision will be considered on a case by case basis.

Business Taxation

What is an institutional investor (for R&D)?

Summary - The FTT found that a bank holding an investment in a company could qualify as an 'institutional investor' for the purposes of R&D relief.

The taxpayer designed and distributed loudspeakers. West Register, a 100% subsidiary of RBS, held 43.75% of its share capital and 26.22% of its voting rights.

The taxpayer claimed an additional 75% deduction for research and development expenditure available to small and medium-sized enterprises (CTA 2009, s 1044) for the period to 30 September 2010. It said that RBS was an institutional investor under EU Recommendation 2003/361.

HMRC refused the claim on the ground that West Register was a “partner enterprise”, which is neither an institutional investor nor a venture capital company.

The taxpayer appealed.

Decision:

The First-tier Tribunal said HMRC's view, taken from illustrative examples in the European Commission's 2005 document The *new SME definition user guide and model declaration*, on the meaning of institutional investor was not supported by the legislation and had “no commercial logic”. The judge was also critical of HMRC's reliance on the European Commission's 2014 document, *Evaluation of the user guide to the SME definition,* to define venture capital company, saying it contained suggestions rather than definitions.

The tribunal said an institutional investor was one that invests on behalf of others in a range of ways. A venture capital company's strategy was to invest in high risk, high return ventures. Neither types of investor would be involved in the day-to-day management of their investments.

The essential test of institutional investment was whether the investor, through its involvement in the company, was putting the business in a stronger market position than others. In this instance, the evidence showed that RBS and West Register had little involvement in the management of the company. The tribunal concluded, therefore, that RBS and West Register were institutional investors.

As the tribunal had been provided with limited evidence about West Register's activities, strategies and risk appetite, it was unable to decide whether it was a venture capital company.

On the basis that West Register and RBS fulfilled the definition of institutional investor, the taxpayer could be treated as a small and medium-sized enterprise and was entitled to claim research and development relief.

The taxpayer's appeal was allowed.

Comments - The FTT rejected HMRC's lines, highlighting in particular that banks do invest on behalf of others and that some institutional investors do not invest on a pooled basis. The category of 'institutional investors' is therefore a much wider category than was suggested by HMRC.

Monitor Audio Ltd v HMRC TC4541

Penalties reduced for CIS failures

Summary – The Tribunal found that the penalties should be substantially reduced but not that he had a reasonable excuse

The taxpayer was a gardener and landscaper. By 2008, he had several employees for whom he operated a PAYE scheme. He also used subcontractors but did not realise that payments to them fell within the construction industry scheme.

HMRC opened an enquiry into the taxpayer's 2009/10 self-assessment tax return and, at the beginning of 2012, the taxpayer submitted monthly construction industry scheme returns for 2008 and 2009.

HMRC imposed late filing penalties totalling £31,500, against which the taxpayer appealed. Recognising that the penalties were excessive, HMRC said they would reduce them to £3,083 but the taxpayer refused the offer.

Decision:

The First-tier Tribunal was not satisfied that the taxpayer had a reasonable excuse for failing to file the monthly returns. The judge said his error was “completely inadvertent and related to unusual transactions outside the ordinary course of his business”. The taxpayer recognised that he should have checked with his adviser, but did not realise the serious implications that would result from his failure to do so.

The tribunal concluded that the TMA 1970, s 98A(2)(b) penalties of £25,500 should be reduced to nil and that those made under s 98A(2)(a) should be reduced to £4,800. Noting that HMRC said they would mitigate the sum to £3,083 regardless of the outcome of the appeal, the tribunal decided greater mitigation would be appropriate and suggested £683.

The taxpayer's appeal was allowed in part.

Comments – This case demonstrates the importance of taking appropriate advice from advisors if circumstances outside of one’s normal experience crop up. The penalties were substantially reduced first by HMRC and secondly by the Tribunal so the appeal was worthwhile.

B Parkinson v HMRC TC4526

For whose benefit was the expenditure incurred – Private or business?

Summary – The Tribunal found that the expenditure was more private than business and consequently EIS relief was refused

Mr H ran a grouse shooting operation. The operation included high quality accommodation in a property next to one of the two moors.

In January 2005, Mr H, the owner of the business, decided to incorporate and transferred the moors, but not the property, into two companies, one of them being the taxpayer company.

He invested £6.5m for shares in the taxpayer in July 2007. Much of that sum was spent on additions and improvements to the property in which accommodation was provided to clients of the business including expensive antiques and art.

In March 2008, Mr H claimed enterprise investment scheme relief for the £6.5m. HMRC refused the claim on the grounds the taxpayer was not carrying on a qualifying trade and the money raised by the share issue had not been used wholly in a qualifying business activity.

Decision:

The First-tier Tribunal agreed that on incorporation, the taxpayer existed in part to confer a personal benefit on Mr H by making improvements to his property. It also existed for an investment purpose. The tribunal accepted that part of the purpose in purchasing the antiques and furniture was to enhance the ambience at the property as part of its trading activities, but it was "inescapable" that there must also have been an underlying investment purpose in their purchase.

The tribunal added: "In a situation where a company with a turnover of £760,000 (as the appellant did in the year to 1 February 2008) spends over £3.5m in a year on art and antiques, there is a distinct impression that the investment activity may be more significant than the trade."

Further, given that the expenditure on the property "dwarfed all other expenditure of the appellant for the next four months and formed a significant and ongoing part of its expenditure up to at least July 2009", the tribunal had no doubt that the taxpayer's purpose of bestowing a personal benefit on Mr H had "a significant impact on the extent of the appellant's activities".

The taxpayer did not meet the requirements of TCGA 1992, Sch 5B para 1(2)(b).

The taxpayer's appeal was dismissed.

Comments – Tax reliefs such as EIS relief are valuable but the expenditure which is eligible is likely to get carefully scrutinised to ensure that it qualifies. The nature and the quantum of the expenditure in this case made it likely that it would fail which was the decision of the Tribunal. The comments by the Tribunal judge are self-explanatory.

East Allenheads Estate Ltd v HMRC TC4513

The onus of proof lies with the taxpayer – Proof of innocence?

Summary – The Tribunal found that the taxpayer had been careless but mitigated the penalty.

The taxpayer was the proprietor of a restaurant. In November 2010, HMRC opened an enquiry under TMA 1970, s 9A into the 2008/09 tax return. After a number of meetings, in March 2013, HMRC concluded that adjustments were required in respect of purchase invoices and petrol receipts, a balancing figure of “capital introduced” and an unidentified cheque deposit. After another meeting a closure notice was issued and a 22.5% penalty was charged.

The taxpayer appointed a new accountant who agreed the adjustment on the purchase invoices and petrol receipts, but not the other items. HMRC reviewed their decision and confirmed it. The taxpayer appealed.

HMRC argued that, although the taxpayer had asserted that the capital introduced was loans from his brothers, no evidence in the way of their bank statements had been produced and the receipts did not accord with their affidavits.

On the capital introduced, this was originally explained as an insurance receipt, but later changed to a loan from a customer.

HMRC concluded that the taxpayer had been careless, but they mitigated the penalty by 50%.

The taxpayer asserted that his first language was not English and that he had depression due to business and family problems. The loans from his brothers were in cash and the wrong description of the capital introduced was a simple mistake. He argued that the penalty was harsh and should be waived.

Decision:

The tribunal noted that it had the power under TMA 1970, s 50(6) to reduce an assessment if it appeared that the taxpayer had been overcharged. However, the judge in *Nicholson v Morris* [1976] STC 269 stated that “TMA 1970 throws on the taxpayer the onus of showing that the assessments are wrong. It is the taxpayer who knows and the taxpayer who is in a position (or, if not in a position, who certainly should be in a position) to provide the right answer … It is the duty of every individual taxpayer to make his own return and, if challenged, to support the return he has made, or, if that return cannot be supported, to come completely clean; and if he gives no evidence whatsoever he cannot be surprised if he is finally lumbered with more than he has in fact received.”

The tribunal noted that the taxpayer had been to university and had written to HMRC in standard business English. It had also been accepted that the capital introduced figure had been a “plug” to balance the bank reconciliation. Despite HMRC's efforts to verify the loan explanations, there was no observable link. The onus was on the taxpayer to show that the adjustment was not unrecorded sales and he had failed to do so. Taking all the facts into account, HMRC's adjustments and the penalty charge were approved.

The appeal was dismissed.

Comments – In cases like this under self-assessment taxpayers may be required to justify figures particularly in businesses which lend themselves to not necessarily paying the correct amount of tax. The summary of the decision highlights the responses of the taxpayer and the responsibilities. Cases like this therefore hang on the credibility of the witnesses.

M Shakeel v HMRC TC4576

The limits of territoriality and the Construction Industry Scheme

Summary - The UT found that deductions were due under the construction industry scheme (CIS), despite the fact that payments were made to a company established in the Isle of Man

The taxpayer, ICM (UK), was a wholly owned subsidiary of ICM (Isle of Man). The Isle of Man company carried on in business in the UK providing subcontractors but was not registered under the construction industry scheme. It set up ICM (UK), which was registered under the scheme for clients to make payments for subcontractors.

After an enquiry into ICM (UK)'s returns, HMRC discovered that the UK company had made substantial payments to the Isle of Man business. They said the sums should have been treated as falling within the construction industry scheme and issued assessments. They also issued a notice cancelling ICM (UK)'s gross payment status.

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

Decision:

The Upper Tribunal found that the relationship between ICM (UK) and the clients was one of contractor and subcontractor for construction industry scheme purposes. Clients contracted with ICM (UK) precisely because they wanted to pay for labour gross without the bother of themselves having to make and account for deductions.

On the relationship between the Isle of Man company and the construction worker, this was one of principal and agent. The company agreed to act for the worker by concluding agreements on his behalf for the supply of his labour and processing the payments that are made in return for that labour. It was clear from the contract that the parties' intention was that the construction worker agreed with ICM (Isle of Man) that it would act on his behalf in bringing the construction worker together with the clients who would employ him.

The judge then turned to the relationship between ICM (UK), ICM (Isle of Man) and the construction worker. She concluded that, on the basis that ICM (Isle of Man) acted as agent for the construction worker in concluding contracts between him as subcontractor and another entity as contractor, the third entity was ICM (UK).

She said: “The client certainly did not want to enter into a contract with the construction worker. On the contrary, it clearly intended to contract with ICM (UK) as an entity registered for gross payment so that it could avoid having to make deductions from the contract payments itself. The construction worker also had no intention of entering into a contract with the client because he wanted to be paid gross rather than under deduction.”

Having established these relationships, the construction industry scheme legislation could be applied without the need to rely on the *Ramsay* doctrine.

Finally, on the territoriality of the construction industry scheme, the judge said parliament could not have intended that, when contractors work in the UK and are paid by the client through a sub-contractor which is incorporated in the UK and registered for gross payment under the scheme, there was no need for the subcontractor to make deductions from the onward payments if the recipient was an Isle of Man company. She said the fact that there was an entity in the chain operating outside the UK did “not take the whole chain out of the territorial scope of the legislation”.

The assessments were correct and HMRC were entitled to revoke ICM (UK)'s gross payment status.

The taxpayer's appeal was dismissed.

Comments – Cases such as this with lots of complex facts and the CIS do not usually involve cross border avoidance of tax. Although the UT did not need to resort to the *Ramsay* doctrine to do so, it effectively unravelled a CIS avoidance scheme by applying the CIS legislation to a rather complex set of facts.

Island Contract Management (UK) Ltd v CRC, Upper Tribunal

Film Schemes and Trading – Goldcrest Film Scheme

Summary - The UT found that the taxpayer had not been trading so that the scheme he had implemented did not work.

The taxpayer, Patrick Degorce, was a hedge fund manager who took part in a tax avoidance scheme known as the “Goldcrest film scheme”. It involved the purchase and immediate assignment of intellectual property rights in two films. He was one of 12 taxpayers who participated and it was agreed that his would be the lead case.

He claimed relief under TA 1988, s 380(1) as a result of losses sustained under the scheme. HMRC considered that the scheme had not given rise to the expected trading losses, as Mr Degorce's activities had not amounted to trading.

The First-tier Tribunal agreed that the taxpayer had not been trading and said the sole purpose of the scheme was to avoid tax. The taxpayer appealed.

Decision:

The Upper Tribunal accepted the First-tier Tribunal's finding that it was “clear before [the taxpayer] entered into the first of the transactions that, at the end of them, minutes later, he would be left only with the income stream. No other outcome was possible”.

It did not matter whether the taxpayer had taken advice or negotiated the transactions because advice and negotiation “do not transform the purchase of an asset, as an income stream is, into a trading activity”. They were not included in the list of badges of trade. Although the exercise was speculative in that it was unknown how much income the taxpayer would receive from the exploitation of rights, there was no element of speculation in the transactions. The outcome was predetermined.

It was also irrelevant that other participants in the transactions were trading commercially.

The taxpayer's appeal was dismissed.

Comments - This was the lead case as eleven other taxpayers had implemented the scheme. By finding against the taxpayers, the UT stated that the case was distinguishable from *Ensign Tankers v Stokes* [1989] STC 705, in which the taxpayer had contributed to the financing of the production of the films as one of the members of a partnership. The case was, however, similar to the recent case earlier this year of *Eclipse Film Partners no 35 v HMRC* [2015] EWCA Civ 95, where the Court of Appeal had found that the taxpayers were not trading.

P Degorce v CRC, Upper Tribunal

Tax and accounting standards

Summary - The FTT found that the transfer of a debt had given rise to a taxable profit on a loan relationship, even though such a profit was not recognised in the company's GAAP compliant accounts.

After Enron's collapse in 2001, the taxpayer submitted substantial claims against the group for failure to fulfil electricity contracts. In 2006, it transferred the claims to a wholly owned subsidiary, TRAIL, which was a controlled foreign company. The claims were TRAIL's only assets. It received £243m for the claims and lent it back to the taxpayer on an unsecured, interest-free basis. In July 2008, TRAIL was wound up.

The transfer of the claims was notified to HMRC under the disclosure of tax avoidance schemes regime on the ground that the arrangement was “to enable a UK company to indirectly realise the value of an existing asset … which had no carrying value under UK GAAP without triggering an immediate tax charge by transferring it to a foreign subsidiary in exchange for the issue of shares”.

HMRC assessed the taxpayer on profits represented by the value of shares received on the transfer of the claims to TRAIL. The taxpayer appealed.

The taxpayer argued that the transfer was not a sale, but an assignment for shares in a wholly owned subsidiary. It did not give rise to a taxable profit. HMRC said the claims were sold for an established market value. The assignment was a “sale” for the purpose of the loan relationship rules.

Decision:

The First-tier Tribunal found that the taxpayer's accounts were GAAP-compliant. Further, the tribunal "should be slow to upset accounts which have been given audit sign-off as GAAP-compliant". The fact that GAAP-compliant accounts resulted in a sum disappearing as part of a tax avoidance scheme did not make them non-compliant.

However, the tribunal said "on any realistic commercial approach", the claims were given a monetary value when they were exchanged for shares. There might have been a sale but it was a "disposal for good consideration".

The tribunal concluded that the GAAP-compliant accounts did not give a fair representation of the profits arising to the taxpayer on the transaction. The economic substance approach of FRS 5 should not override the requirement *of* FA 1996, s 84(1) that the profits from the transaction should be fairly represented.

The judge said the tribunal had "used s 84(1) as an anti-avoidance rule to stop accounting principles being used as a way of taking profits out of the tax net and … this is in line with the proposed Finance Bill 2015 changes to the loan relationship code".

The taxpayer's appeal was dismissed.

Comments – As we see few cases regarding the interaction of accounts and tax it was not surprising that FTT accepted that it 'should be slow' to find that accounts prepared in accordance with accepted principles were not adequate for tax purposes. However, in this case, the First Tier Tribunal felt compelled to make such a finding in the exceptional circumstances of this case.

GDF Suez Teesside Ltd (formerly Teesside Power Ltd) V HMRC TC4590

Main object of transaction – Obtaining of capital allowances?

Summary - The FTT found that the obtaining of capital allowances had been one of the main objects of a transaction, so that tax relief was not available.

The taxpayer, a finance leasing company, claimed capital allowances at 25% under CAA 2001, s 123 on the purchase of two merchant ships. HMRC refused the claim. The taxpayer appealed. The case proceeded through the First-tier Tribunal and Upper Tribunal, which allowed the appeal, to the Court of Appeal, which found for HMRC and remitted it to the First-tier Tribunal to reconsider whether the taxpayer's purpose was to obtain a 25% writing-down allowance.

Decision:

The First-tier Tribunal said it was clear that the objects of the taxpayer's transactions were commercial. However, the availability of the capital allowances made the transactions more likely to proceed. The test was not whether the "primary object of the transaction … is to obtain a writing-down allowance, but whether any one of a series has that object". Realistically, this was the case.

Once it was understood that the allowances might be available, it was ensured that the steps were taken to meet the statutory requirements. The judge said the obtaining of the 25% allowances was a main object or one of the main objects of the transactions. The taxpayer's appeal was dismissed.

Comments - This decision is the latest instalment of a judicial saga that began in the FTT in 2011, before proceeding through to the UT and Court of Appeal. Court of Appeal has remitted the case to the FTT.

Criticising the drafting of s 123(4), the FTT highlighted that it was challenging to identify the dividing line between an object which, though not paramount, is a main object and between an object which is a subsidiary object. The decision was that this case fell on the wrong side of the line, as capital allowances had been considered when structuring the transaction.

Lloyds Bank Leasing (No 1) Ltd v HMRC TC4578

Discontinued but when – Important for AIA?

Summary – The UT found that a trade discontinued at the end of a chargeable period was discontinued during that period.

The taxpayer was a self-employed air conditioning engineer with an accounting year end of 31 March. He incorporated from 1 April 2009 and started trading as CC Ltd. He claimed annual investment allowance on a new van he bought in July 2008. HMRC refused the claim on the ground that it related to the period when he was self-employed.

The First-tier Tribunal dismissed the taxpayer's appeal, saying his business after he incorporated was not the same as his activity before. The taxpayer appealed.

The issue before the Upper Tribunal was whether the First-tier Tribunal had erred in law in deciding that the taxpayer had permanently discontinued his trade on 31 March 2009.

Decision:

The judge said it was clear that CC had begun trading during the accounting period starting on 1 April 2009 and the taxpayer had not operated his self-employed business in that time. He had not prepared any self-employed accounts after 31 March 2009 and, therefore, the First-tier Tribunal was correct to conclude that the taxpayer did not trade on 1 April.

The question remained whether the discontinuance of a trade at the end of a chargeable period was a “discontinuance in the chargeable period”. The judge said it was. It followed from the finding that the taxpayer's trade did not exist on 1 April that the trade had been discontinued before then. He discontinued the trade at midnight on 31 March, which was the last moment of the accounting period ending on that date. It was not possible for the trade to end at a point in “between the end of one accounting period and the start of another that falls in neither period”.

The judge accepted HMRC's argument that the end of a period is part of that period. He concluded: “A discontinuance of a trade at the end of a chargeable period is a discontinuance of that trade in that period.” The taxpayer's appeal was dismissed.

Comments - This decision confirms that what happens at the end of a chargeable period happens during that period. This may be relevant in many circumstances beyond the realm of capital allowances.

D Keyl v CRC, Upper Tribunal

Does Dutch withholding tax comply with EU law?

Summary - The CJEU has found that the Dutch legislation imposing withholding tax on non-residents, without the appropriate mechanism for its refund or deduction, breaches EU law principles.

Mr Miljoen and X were Belgium resident and had been paid dividends on the shares they owned in listed Dutch companies. The Dutch tax authorities thought that withholding tax was due on the dividends under Dutch law. However, Mr Miljoen and X asserted, as non-resident taxpayers, that they had suffered discriminatory treatment prohibited by TFEU Art 63.

Société Générale, a French company, owned shares in Dutch listed companies and had suffered withholding tax on dividends at the rate of 15%. The company had been allowed to offset the withholding tax against its corporation tax liability in France until it had been loss making. The Dutch tax authorities had then refused to reimburse it. The company also argued that it had suffered discriminatory treatment.

Dutch withholding tax on dividends is applied to both resident shareholders and to non-resident shareholders at the same flat rate. The issue was therefore whether by only making the mechanism for deducting or reimbursing the withheld tax solely available to resident taxpayers, the Dutch tax legislation was in breach of TFEU as a restriction on the movement of capital.

Decision:

The CJEU stated that it was for the referring court to decide whether the burden imposed on non-residents was heavier than that imposed on residents. For natural persons, it noted that the comparison must be run on a yearly basis by reference to all dividends paid by Dutch companies to a taxpayer. It had to take into account the exemption of capital provided for under Dutch legislation. For the purpose of comparing the tax burden of companies, only expenses which were directly linked to the actual payment of the dividends must be taken into account.

In the event that a difference in treatment was established, it could be justified neither by a difference in situation between resident and non-resident taxpayers, nor by the effects of the relevant double tax treaties, as neither of them fully eliminated the effect of the withholding tax.

Comments – The result in this case will generally be good news for taxpayers who hold shares in Dutch companies. It remains to be seen whether in these particular three cases, the domestic courts will find that a difference in tax burden between residents and non-residents is established.

J. B. G. T. Miljoen (C-10/14), X (C-14/14), and Société Générale SA (C-17/14) v Staatssecretaris van Financiën

Dividends and the freedom of establishment

Summary - The CJEU decided that the unequal tax treatment of dividends received by the parent company of a tax integrated group, depending on whether the subsidiaries were established in the same member state as the parent company, did not comply with EU law.

Groupe Steria was the parent company of a tax integrated group. Steria, a member of that group, had holdings of more than 95% in subsidiaries established in France and in other member states. Under French law, the dividends received by Steria from the subsidiaries established in other member states were deducted from its net total profits, except for a proportion of costs and expenses — this exception was fixed at 5% of the net amount of the dividends received and represented the costs and expenses borne by the parent company, relating to its holding in the subsidiary that distributed the dividends. No such exception existed for dividends received from French subsidiaries. Steria claimed repayment of the taxes corresponding to the 5% of dividends on the basis that the French rules were incompatible with TFEU art 49 (freedom of establishment), given the unequal treatment of dividends received by a parent company depending on whether the subsidiary was established in France.

Decision:

The CJEU stated that the situation of companies belonging to a tax integrated group is comparable to that of companies not belonging to such a group. In each case, the parent company bears the costs and expenses related to its shareholding in the subsidiary; and the profits made by the subsidiary can be subject to economic double taxation or to a series of tax charges.

Therefore, it could not be inferred from the *X Holding* case that any difference in treatment between companies belonging to a tax integrated group and companies not belonging to such a group was compatible with TFEU art 49. The CJEU rejected arguments regarding the cohesion of the tax system, noting that it was not possible to identify any direct link between the tax advantage at issue and a tax disadvantage resulting from the neutralisation of intragroup transactions in a tax integrated group.

Comments - This case sets out the limits of the principles set out in the *X Holding* case. Although Member states can limit the membership of tax integrated groups, they may be forced to make some of the advantages of tax integration available to non-group members established in other Member states.

Groupe Steria v Ministère des Finances et des Comptes publics (C-386/14)

Planning for the new 2016 dividend changes (Lecture B916 – 18.31 minutes)/(Lecture B917 – 21.02 minutes)

With effect from next April, the 10% dividend tax credit is abolished and so dividends will no longer be grossed up in the personal tax computation. Instead, individuals will be entitled to a £5,000 dividend tax allowance. This allowance does not reduce the taxable income, but is better thought of as a nil rate band. Dividends are taxed as before by adding them to the taxpayer's other income to see whether they fall into the basic rate, higher rate or additional rate bands.

The first £5,000 is then covered by the dividend allowance and the excess becomes liable to tax at the following rates:

- 7.5% in the basic rate band (currently 0%)
- 32.5% in the higher rate band (currently 25%)
- 38.1% in the additional rate band (currently 30.6%)

Detailed examples of how this works was covered in last month's notes.

This change is expected to raise around £2bn a year, primarily from owner managed businesses adopting a low salary high dividend extraction policy.

Basic rate OMBs

In 2016/17 a taxpayer who withdraws £8,000 as salary will leave £3,000 of the 2016/17 personal allowance (£11,000) to set against their dividend income. Combining this with the £5,000 dividend allowance, it means that the taxpayer can take up to £8,000 of dividends before any tax is due. Clearly these numbers are doubled where a husband and wife run the business together.

Any clients taking in excess of these limits will suffer an increased tax liability at a rate of 7.5%.

Example

	2015/16	2016/17
	£	£
Salary	8,000	8,000
Dividend income received	27,000	27,000
Plus tax credit	3,000	
	38,000	35,000
Less: Personal allowance	10,600	11,000
Taxable income	27,400	24,000

Tax at	10%	2,740	0% on	5,000	0
			7.5% on	19,000	1,425
Less tax credit		2,740			
Tax due		Nil			1,425

Base rate taxpayers drawing a salary of £8,000 and dividends in excess of £8,000 will be worse off in 2016/17. The increased tax will be 7.5% of the dividends in excess of £8,000 i.e. £19,000 x 7.5% = £1,425 in the example above.

Base rate payers should be advised to **utilise the base rate band** of £31,785 in 2015/16 by accelerating dividends. Assuming the company has retained profits, the company can pay an additional interim dividend in 2015/16 with a view to utilising the base rate band.

Generally OMBs will be paying a salary of £8,000 or £10,600 in 2015/16. Salaries at £10,600 will utilise the £2,000 employers national insurance exemption. The corporation tax relief on the additional £2,600 salary exceeds the small amount of employees national insurance due.

Depending on the level of salary drawn (and assuming no other income) the optimum dividend level to maximise the basic rate band will be as follows:

			2015/16			2015/16
			£			£
Salary			8,000			10,600
Dividend income			30,950			28,600
Plus tax credit			3,439			3,178
			42,389			42,378
Personal allowance			10,600			10,600
Taxable income			31,789			31,778
Tax at	10% on	31,785	3,179	10% on	31,778	3,178
	32.5%	4	1			
Less tax credit			(3,179)			(3,178)
Tax due			1			Nil

Consequently the optimum dividend levels to utilise the base rate band for 2015/16 will be £30,950 when drawing an £8,000 salary or £28,600 when drawing a £10,600 salary.

If money is available, they can withdraw the additional dividends and then reintroduce the money as a loan if the company needs it. If money is not available the accelerated dividend can be taken as an interim dividend that is credited to their loan account in the books and records of the company. If records are minimal then make sure the minutes state that the interim dividend is credited immediately to director's loan account.

Is it worth taking any more dividends this year?

The answer to this question will depend on the taxpayer's intent. If the taxpayer plans to withdraw dividends that fall only into the basic rate band next year, then the 7.5% in 2016/17 is cheaper than pushing dividends into the 25% band in 2015/16 so there no point taking more than base band in 2015/16.

If higher dividend withdrawal is expected going forward then pushing dividends into the 25% band in 2015/16 is cheaper than 32.5% in future years.

Any accelerated dividends drawn in 2015/16 can be left on loan account. The taxpayer should be advised that they will have to pay any tax due on the accelerated dividend by 31 January 2017. The payments on account for 2016/17 should be reduced as the income was exceptionally high in 2015/16 by way of the accelerated dividend.

High rate OMBs

Let's compare the position of a taxpayer who normally withdraws £60,000 dividends each year and consider whether they are better off accelerating some of the 2016/17 dividend into 2015/16.

			2015/16			2016/17
			£			£
Salary			8,000			8,000
Dividend income			60,000			60,000
Plus tax credit			6,667			
			74,667			68,000
Personal allowance			10,600			11,000
Taxable income			64,067			57,000
Tax at	10% on	31,785	3,178	0% on	5,000	0
	32.5% on	32,282	10,492	7.5% on	27,000	2,025
				BRB	32,000	
Less tax credit			(6,407)	32.5% on	25,000	8,125
Tax due			7,263			10,150

If £60k dividend is withdrawn in both years, the tax due over the two years is £17,413.

If the taxpayer accelerated £20,000 of the 2016/17 dividend into 2015/16 he would save £1,500 i.e. £20,000 x 7.5%. When your spouse also owns shares the savings can be doubled.

			2015/16			2016/17
			£			£
Salary			8,000			8,000
Dividend income			80,000			40,000
Plus tax credit			8,889			
			96,889			48,000
Personal allowance			10,600			11,000
Taxable income			86,289			37,000
Tax at	10% on	31,785	3,178	0% on	5,000	0
	32.5% on	54,504	17,714	7.5% on	27,000	2,025
				BRB	32,000	
Less tax credit			(8,629)	32.5% on	5,000	1,625
Tax due			12,263			3,650

By accelerating £20,000 of the 2016/17 dividend into 2015/16 we see the total liability over the two years fall to £15,913 so saving £1,500 (20,000 x 7.5%). The taxpayer will have to be prepared to pay their higher rate tax on this £20,000 dividend a year early but the saving is worthwhile. As always retained profits will need to be available to support and accelerated dividend.

Should we accelerate dividends so that 2015/16 income exceeds £100,000?

Once taxable income reaches £100,000, the personal allowance is tapered away. What effect does this have on the level of accelerated dividends?

With an £8,000 salary and annual dividends of £80,000 the tax liabilities for the two years is a follows:

			2015/16			2016/17
			£			£
Salary			8,000			8,000
Dividend income			80,000			80,000
Plus tax credit			8,889			
			96,889			88,000
Personal allowance			10,600			11,000
Taxable income			86,289			77,000
Tax at	10% on	31,785	3,178	0% on	5,000	0
	32.5% on	54,504	17,714	7.5% on	27,000	2,025
				BRB	32,000	
Less tax credit			8,629	32.5% on	45,000	14,625
Tax due			12,263			16,650

The total liability over the two years is £28,913. So let's shift £45,000 from 2016/17 to 2015/16.

			2015/16 £			2016/17 £
Salary			8,000			8,000
Dividend income			125,000			35,000
Plus tax credit			13,889			
			146,889			43,000
Personal allowance			Nil			11,000
Taxable income			146,889			32,000
Tax at	10% on	31,785	3,178	0% on	5,000	0
	32.5% on	115,104	37,409	7.5% on	27,000	2,025
				BRB	32,000	
Less tax credit			13,629	32.5% on	0	0
Tax due			26,958			2,025

By shifting £45,000 of the dividend to 2015/16 we can see that in 2015/16 the taxpayer's income level results in no personal allowance being available and the tax liability is £28,983. Consequently, it is not worth accelerating the dividends so as to create income above £100,000 as there are no savings to be made.

If the taxpayer has already lost their personal allowance in 2015/16 then it would be worth accelerating dividends to secure the 7.5% saving. Taxpayers earning more than £121,200 in 2015/16 would not be entitled to any personal allowance.

Payment of dividends

Accelerated dividends will need to be by way of an interim dividend and we must ensure these interim dividends are "paid" in 2015/16 to secure the 7.5% tax saving. Interim dividends are technically revocable so an interim dividend is not paid unless the shareholder receives the money or the money is put unreservedly at the shareholders disposal i.e. entered into the books and records of the company.

Example

Sandra prepares her monthly management accounts on QuickBooks and her retained profits are at a reasonable level. She has a salary of £8,000 and dividends of £15,000 per year (£1,250 per month or £3,750 per quarter).

She has no staff so she increases her salary so that she utilises the £10,600 personal allowance by the end of the tax year.

At the start of each quarter a minute is normally prepared for £3,750 which will allows her to draw a monthly dividend of £1,250. The minutes always refers to sufficient profits to cover the £3,750 interim dividend.

She now needs to increase her dividends to the optimal £28,600 for 2015/16 and decides that the £13,600 extra dividend will sit outside of the normal quarterly minutes.

If Sandra credits the £13,600 to her loan account via a Quick Books journal entry on 5 October 2015 (say) then that will be the date of payment for her extra £13,600 dividend. This is the most prudent thing to do. A minute should be prepared to support the interim dividend but it is the crediting of the entry in Sandra's books and records that creates the payment date.

If Sandra does not make any entry in her Quick Books program then the payment date will be when her accountants are preparing her year end accounts and that may be post 5 April 2016.

Alternatively, if the minute states that the £13,600 dividend is to be *credited immediately to Sandra's loan account* and is available for draw without restriction then arguably the date of the minute is the payment date.

Transferable married couples allowance

From 6 April 2015 where one spouse or civil partner is not using their personal allowance they can transfer up to 10% of the allowance to their spouse or civil partner. Remember this is not available if either spouse is a high rate taxpayer so it is only worth £212 in tax terms for 2015/16.

There may be directors who are drawing £8,000 plus basic rate dividends and possibly also drawing down on a loan account. In 2015/16 the dividend element that is within the personal allowance is not repayable and so the personal allowance is not being fully utilised. It is possible that their spouse has employment income that is less than the higher rate threshold, in which case it is worth moving the 10% allowance to that spouse.

In 2016/17, the couple will need to think again as dividends will no longer have tax credits. It will be important to consider at what rate each spouse is using the personal allowance. The director might be utilising the personal allowance at 7.5% while their spouse could utilise it at 20%. By transferring the 10% allowance a £137.50 saving is made (£11,000 x 10% x 12.5%).

Planning in 2016/17

Dividends will still be the optimum means of extraction but they will be marginally more expensive next year.

The combined corporation tax and dividend tax rates of extracting £100 of corporate profit will be:

- Basic rate taxpayer – 26.0% (2015/16 - 20%)
- Higher rate taxpayer – 46% (2015/16 - 40%)
- Additional rate taxpayer 50.5% (2015/16 - 45%)

In 2016/17 we could aim to maximise the £5,000 allowance for family members generally.

If you have a child going to university, then a £5,000 dividend to your child should cover the accommodation costs. Note that a higher rate parent would have to have a dividend of £7,400 to net £5,000. Consider moving some shares into your child's hands so that they receive the dividends.

You could gift a proportion of your shareholding to your child to facilitate the £5,000 dividend. Gift relief would cover the CGT or if the shareholding was minimal – say 5% - the value is likely to be quite low so the annual exemption might cover the value of the gift. If the taxpayer has capital losses these could also be utilised.

The settlements legislation will not apply as your child is over 18 and using the dividend for their own purposes e.g. university accommodation.

Alternatively new shares could be issued. The employment related security legislation will not be in point as the gift is by way of a family relationship rather than employment. Alphabet shares with no capital rights are likely to prompt HMRC attention but that is not to say they will not work.

Parents looking to pay tuition fees could push this concept a little further. A high rate taxpayer would have to take a dividend of £13,333 to net £9,000. Generous parents could shift some of their shareholdings so as to ensure a £15,000 dividend went to the child. The dividend allowance means that £5,000 of the dividend is tax free. If the child was not using all their personal allowance via part time work then part of the remaining £10,000 dividend would be covered by the personal allowance. Any excess would be taxed at 7.5%. Quite a saving. Post tax, the dividend would be enough to cover accommodation costs and tuition fees with a little bit spare for trips home!

Going forward I can also see company pension contributions being more popular. Those taxpayers drawing an annual salary in the region of £8,000 can only contribute up to £8,000 into their pension fund personally but the company is not subject to such a restriction. With the generous pension freedom rules it might be prudent to reduce dividends so as to allow corporate pension contributions. There is however

an annual allowance which limits total contributions to an individual's pension fund to £40,000 per annum. Any unused relief can be carried forward for three years.

Owner managers might also start using overdrawn loan accounts as a means of extraction. The company would pay the 25% s455 tax but remember that this is repayable when the loan is repaid. The effective tax rate each year is 1.2%. This is calculated as the official rate of interest, currently 3%, times the higher rate of tax (40%). Where clients are looking to retire in four or five years time, building up a loan account which they can then extract as capital on a formal liquidation would be attractive. The 10% entrepreneurs' rate is currently due on capital extractions from a trading company.

VAT

Harsh but not unfair – UT reverses FTT

Summary - The UT determined that a default surcharge imposed on Trinity Mirror (the publisher of newspapers and magazines) for making a payment one day late had been proportionate.

The taxpayer was one day late making its VAT payment for the December 2007 period. Apart from one other delayed payment, the taxpayer's VAT record was perfect.

HMRC imposed a default surcharge of £70,000, reduced from £95,900. The taxpayer appealed to the First-tier Tribunal. After referring to the decisions in *Enersys Holdings UK Ltd* and *CRC v Total Technology (Engineering) Ltd*, the tribunal discharged the surcharge on the basis that it was disproportionate.

HMRC appealed to the Upper Tribunal.

Decision:

Mrs Justice Rose said the First-tier Tribunal's conclusion that the surcharge had been disproportionate was not one that could be arrived at as a matter of law. Its reliance on *Enersys* had been misguided. The tribunal had taken the “false premise” that the gravity of the offence was dictated by how often the tax-payer had defaulted. This failed to recognise that the surcharge was based on the VAT unpaid.

Setting aside the First-tier Tribunal's decision, the judge said the correct approach was to determine whether the penalty went beyond what was necessary to achieve the objectives of the default surcharge regime and whether it was so disproportionate to the gravity of the error that it became an obstacle to attain the underlying aim of the principle of fiscal neutrality.

Quoting Lord Justice Simon Brown in *International Transport Roth GmbH v Secretary of State for the Home Department*, was “the scheme not merely harsh but plainly unfair, so that, however effectively that unfairness may assist in achieving the social goal, it simply cannot be permitted?”

She concluded that there were no exceptional circumstances in the taxpayer's case that could render the surcharge disproportionate. A penalty based on a modest percentage (2%) of the amount of VAT unpaid by the due date could not be regarded as going beyond the objectives of the default surcharge regime.

The seriousness of the default had to be judged according to the relevant factors: it had been a second default and it had been a large amount. The penalty was calculated according to the rules “of a rational scheme that could not be characterised as devoid of all reasonable foundation”.

The judge concluded that the “penalty could be considered harsh, but could not be regarded as plainly unfair”.

The surcharge was upheld and HMRC's appeal was allowed.

Comments - Neil Warren, independent VAT consultant, commented: “The decision confirmed that the *Enersys* case, where a default surcharge was overturned on the argument of proportionality, was a one-off outcome caused by exceptional circumstances.” The case provides a thorough analysis of two key cases on default surcharge: *Enersys*; and *Total Technology* [2012] UKUT 418. It confirms that the proportionality of a default surcharge must be assessed by reference to the principle of fiscal neutrality.

Trinity Mirror plc v CRC, Upper Tribunal

Is Bridge a sport?

Summary - The UT decided to refer the question of whether bridge is a sport to the CJEU.

The English Bridge Union organised tournaments and charged players an entry fee to take part. The Charity Commission decided that bridge fell within the definition of sport in the Charities Act 2006, s 2(3)(d). HMRC, however, ruled that it was not a sport for the purposes of the VAT exemption in VATA 1994, Sch 9 group 10.

The First-tier Tribunal agreed with HMRC. The union appealed to the Upper Tribunal.

Decision:

Mrs Justice Asplin referred the case to the Court of Justice of the EU to decide whether bridge was a sport within article 132(1)(m) of the Principal VAT Directive. This was because the tribunal could not “with complete confidence resolve the issue of the community law meaning of 'sport'” to determine the appeal.

The judge said the meaning of sport should be “autonomous” and apply across the entire EU. After reviewing relevant cases, it was clear that discrepancies in its meaning had appeared and therefore it would not help to add another domestic view.

Comments - Having first opposed a reference to the CJEU at the FTT, HMRC had become 'neutral' on the issue at the UT, on the basis of evidence suggesting inconsistencies between member states. It is interesting to see a case such as this as most independent non tax observers would not classify a card game as a sport.

The English Bridge Union Ltd v CRC, Upper Tribunal

Residual input tax is recoverable

Summary – The Court of Appeal determined that a hire purchase (HP) company's input tax was attributable to both chargeable and exempt supplies.

Volkswagen Financial Services (UK) Ltd was a wholly owned subsidiary of Volkswagen Financial Services AG, which was ultimately owned by Volkswagen AG.

The company made taxable and exempt supplies, making it a partially exempt trader for VAT. An issue arose over the treatment of the residual input tax on general overheads. VFS (UK) treated each deal as one taxable transaction: the sale of the vehicle at cost price, and one exempt transaction: the finance element, and split the residual input tax equally.

HMRC argued that the residual input tax in respect of hire purchase transactions was not deductible.

The First-tier Tribunal allowed the company's appeal, but the Upper Tribunal overturned that decision. It ruled that the residual cost inputs had no direct and immediate link with VFS (UK)'s business, apart from the small taxable elements of its finance business. The company appealed.

Decision:

Lord Justice Patten in the Court of Appeal said the taxpayer was not a bank. It provided a service to Volkswagen customers who wished to buy a car on hire purchase. To do this, it had to supply the vehicle and the finance; neither part could exist without the other. The First-tier Tribunal had been entitled to conclude that the general overheads had been used in part for making taxable supplies of vehicles.

The judge accepted the company's proposed recovery rate of 50%.

The taxpayer's appeal was allowed.

Comments - The Court of Appeal noted that the UT had criticised the FTT for looking at the transactions through 'VAT-tinted spectacles', pointing out that this was what the UT should have done. Once it was accepted that the taxable supply (the cars) was part of the economic activities of the taxable person, the use of the overheads to fund that business was sufficient to establish the direct and immediate link required by the CJEU's case law.

Volkswagen Financial Services (UK) Ltd v CRC, Court of Appeal

Overclaimed input tax not allowed

Summary – The Tribunal rejected an appeal against a penalty regarding an overclaim for input tax

The company, Gdeco, built new homes. The director, W, dealt with invoicing, record keeping and submitting VAT returns.

At a VAT visit, the HMRC officer was concerned about two matters.

First, an invoice to Gdeco for construction work from an associated company (Oakstone Homes Ltd) also controlled by W, charged VAT of £4,560, although it should have been zero rated. Gdeco claimed the input tax in its VAT return, although the other company had not accounted for the output tax because, at the time of the visit, its VAT return was outstanding. The officer disallowed the claim.

Second, Gdeco claimed input tax of £1,699 on the purchase of a photo booth. This had been bought in April 2014 for the director's son's business. The director said that he planned to lease the booth to his son for a monthly fee but he ultimately intended to sell it to him. However, by September 2014, the company had not issued any lease invoices to the son.

This claim was also not allowed on the basis that the purchase was not for the purpose of Gdeco's business. HMRC issued a "careless behaviour" penalty of 20.25% for both errors. The taxpayer appealed.

Decision:

The First-tier Tribunal supported HMRC's decision, and said HMRC had been "generous in describing this behaviour as careless".

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, commented: "A more sensible approach would have been for the director to have produced a proper hiring agreement in advance with his son, allowing a rent-free period for the use of the photo booth followed by the charging of a commercial rent if his genuine intention was to treat the purchase as a business transaction. This would have protected his input tax claim on the purchase of the booth."

"This is an important lesson about VAT and tax: just because a transaction takes place with a relative or friend, it is important that it is done on normal commercial terms, otherwise problems with HMRC challenging input tax recovery could arise."

Gdeco Ltd v HMRC TC4451

Exclusive occupation of land exempt not standard rated

Summary – The Tribunal found in favour of a taxpayer in circumstances very similar to HMRC's own guidance

The taxpayer organised craft fairs in Dorset and accounted for output tax on admission fees paid by the public but not on the income she received from pitches sold to stallholders, which she treated as exempt supplies of land. HMRC said the supply to the stallholders was a standard-rated package of taxable services, designed to give the business the opportunity to trade.

The taxpayer appealed.

Decision:

The First-tier Tribunal looked at the exemption in article 135 of the Principal VAT Directive (VATA 1994, Sch 9 group 1) for the "leasing or letting of immovable property" in relation to whether a stallholder had exclusive use of the land for his period of hiring, and whether the payment for space was the key benefit he obtained from the taxpayer. The court disagreed with HMRC that the taxpayer was providing taxable organisational services to the stallholders.

The judge said: "The reference to the show or event in the terms and conditions does not, in our view, impose any organisational requirements on Mrs Zombory-Moldovan [the taxpayer] but merely sets out the context of the agreement, ie there will be a craft fair." He concluded that the "effect and economic reality" of the arrangement was that the taxpayer granted the stallholder a licence to offer for sale specific types of goods on the dates in the booking form.

The stallholder had exclusive occupation of the pitch: the supply of space was an exempt supply of a licence to occupy land.

The taxpayer's appeal was allowed.

Comments - Neil Warren, independent VAT consultant, commented that he was surprised that HMRC pursued this case “because VAT public notice 742 confirms that exemption will apply as a land supply in relation to 'granting traders a pitch in a market or at a car boot sale', which seemed to be the exact supply here”. He added: “The key approach in situations where there is doubt about the nature of a land supply is to consider the contract between the tenant and landlord and the benefits the tenant expects to receive when he pays his money.”

Kati Zombory-Moldovan trading as Craft Carnival v HMRC TC4428

Golfing VAT arrangement abusive

Summary – The UT found that arrangements implemented by a partnership were abusive.

The Hilden Park Partnership, which owned and operated a golf club, had transferred its business to two companies that were limited by guarantee and prohibited from distributing profits. It had retained the golf course, which it let to the two companies, along with the driving range, changing rooms and health club. In 2005, the partnership was converted into a limited liability partnership.

The taxpayer considered that it was no longer proprietor of the club, that the supplies of the right to play golf were made by the companies and claimed it was making exempt supplies of land to the companies. Further, the non-profit making companies were making exempt supplies of sport services.

HMRC ruled that the arrangements were an attempt by the taxpayer to avoid VAT on supplies of sporting services and assessed the taxpayer for this.

Decision:

The First-tier Tribunal concluded that the arrangements were artificial. They were intended to create a picture of fully autonomous non-profit making companies running the business even though, in reality, the taxpayer remained in control and in a position to extract any profit from the companies. The taxpayers appealed.

The Upper Tribunal agreed with the First-tier Tribunal that the scheme was an abuse of law within *Halifax plc and others v CCE* [206] STC 919.

HMRC were correct to redefine the transactions and treat the supplies made by the companies as made by the partnership and LLP.

The taxpayers' appeal was dismissed

Comments - The UT stated that the burden of establishing abuse under the *Halifax* principle fell on HMRC who must therefore show that a tax advantage was contrary to the VAT directives and that the essential aim of the transactions was to obtain a tax advantage.

Additionally, in applying the *Halifax* principle, the UT referred extensively to the recent Supreme Court's decision in *Pendragon*, commenting that it may be necessary both to analyse each transaction in a scheme individually and also to consider the effect of the scheme as a whole when identifying the essential aim of the transactions**.**

Massey and another trading as Hilden Park Partnership; Hilden Park LLP v CRC, Upper Tribunal

Bitcoin exchange transactions tax treatment

Summary - The advocate general (AG) has opined that exchange transactions involving bitcoin should be exempt from VAT.

Mr Hedqvist intended to carry out an online business of currency exchange solely between bitcoin and Swedish krona. The issue was the treatment of transactions involving the exchange of bitcoin currency for conventional currency. Bitcoins can only be used electronically and are created by an internet algorithm.

Decision:

The AG considered firstly that bitcoins were simply a means of payment and, as such, their transfer did not trigger any liability to VAT. However, as Mr Hedqvist intended to charge a commission for his services, the tax treatment of his services needed to be determined.

The AG considered that these services did not fall within the scope of the Principal VAT Directive art 135(1)(f) (dealing with shares and bonds), as bitcoins do not carry rights against companies and do not represent debt. As for art 135(1)(e) ('currency, bank notes and coins'), the AG accepted that both krona and bitcoin were means of payment, so that the exemption should apply but for the requirement that both means of payment be 'legal'.

The AG opined that the objective of art 135 was to facilitate the conversion of currencies by limiting their taxation. In the absence of a substantial difference between bitcoin and 'legal currencies', the exemption must therefore apply to transactions involving bitcoin.

Comments - Bitcoin is still a relatively new concept. Therefore any case law clarifying its status is extremely useful. The opinion of the AG is essentially consistent with HMRC guidance. It remains to be seen whether it will be followed by the CJEU**.**

Skatteverket v David Hedqvist (C-264/14)

Medical care provided by subcontractors and contractors

Summary - The FTT found that a contractor and a subcontractor could both be making exempt supplies of medical care to the final recipient.

Two partners of an existing dental practice (CDP), which provided dental services to an NHS trust, had set up City Fresh to act as a subcontractor of CDP.

The key issue was whether the supplies by City Fresh were exempt supplies of medical care under VATA 1994 Sch 9 Group 7 item 2.

Decision:

The FTT commented that there was no need for supplies of medical care to be made directly to the final patient. The FTT therefore rejected HMRC's argument that only one entity in a chain could be making an exempt supply of medical services to patients. The FTT stated that 'in practice, the dentists were looking in the mouths of NHS patients'.

Additionally the FTT found that there was no supply of staff. The two dentists' day to day activities remained unchanged in the absence of any supervision by CDP.

Comments - In the absence of abuse and in circumstances of a complete coincidence between the services provided by each entity in the chain, the nature of the services could not be treated differently for different parties in the chain. Both parties were therefore making exempt supplies of medical care.

City Fresh Services Ltd v HMRC [2015] UKFTT 364

Optional insurance provided with car hire was a separate supply

Summary - The FTT found that the supply of optional insurance together with that of car hire was not a single composite supply.

Wheels ran a taxi business. Some of the drivers rented its cars for £120 per week and they had the option of adding insurance for an additional £45 per week. The key issue was whether the payment for insurance was for a separate and exempt supply or was part of single standard rated supply.

Decision:

The FTT noted that the term 'block policy' (considered in *Card Protection Plan* (C-349/96)) was not defined, although it was covered in HMRC guidance in *Notice 701/36*. However, its suggested characteristics were a contract between insurer and policy holder, who in turn could procure insurance or insurance cover for third parties. A 'fleet policy', such as that of Wheels, could therefore fall within the scope of the exemption.

The FTT determined that the supply of insurance made by Wheels qualified for the exemption. It was a separate and independent supply, optional from the viewpoint of the driver, and separate from the supply of the vehicle and the supporting radio service. Whether the driver obtained his own independent insurance cover or not, the supplies of the vehicle and the radio service could be enjoyed similarly.

Comments - Although the supplies of car hire and insurance were provided by the same entity at the same time, the FTT found that they were separate supplies for VAT purposes.

Wheels Private Hire v HMRC [2015] UKFTT 363

Cattle supplies – VAT treatment?

Summary – The Tribunal found that the farmers in question were making an exempt supply of land

The taxpayers were in an agricultural contracting partnership. They charged other farmers for keeping their cattle in eight sheds on their property. The supplies were treated as VAT exempt on the basis that they made an exempt supply of a right to occupy land and a zero-rated supply of animal feed.

After an assurance visit, HMRC decided the supplies should be standard rated on the basis that the supply was one of animal husbandry. The taxpayers provided other services, such as provision of feed, water and general care. The taxpayers appealed.

Decision:

The First-tier Tribunal determined that the services provided by the taxpayers fell short of a full care service. They were responsible for ensuring the cattle were fed and watered, but they did not provide all other needs. The other farmers were paying for the assurance that their animals were kept in a safe and secure environment rather than to have them fully looked after. The taxpayers were therefore making an exempt supply of land. Any additional services were part of that single exempt supply rather than the care.

The taxpayers' appeal was allowed.

Comments - Neil Warren, independent VAT consultant, noted: “It is likely that all of the cattle owners were in business and VAT registered. It would have been simpler, therefore, for the taxpayers to have accepted HMRC's view that the supplies were standard rated and issued late VAT-only invoices to their customers. This would seem to be an easier option than challenging HMRC's view that the supplies were standard rated in what has always been a grey area of the tax. It is unlikely that cattle would be used for non-business/ leisure purposes in the same way as a horse.”

D Owen, A Owen v HMRC TC4469

Evidencing an overpayment of VAT as matter of fact

Summary - The UT confirmed the FTT's finding that the appellant had not established, as a matter of fact, that it had overpaid VAT.

The appeal related to a claim for repayment of VAT by Why Pay More For Cars (WPMC). WPMC had accounted for output tax on bonus payments received from certain car manufacturers, incorrectly assuming that the bonus payments were consideration for taxable supplies of services by WPMC to the car manufacturers.

Following the ECJ decision in *Elida Gibbs* (C-317/94), HMRC agreed that VAT was not due on the receipt of the bonus payments, which should have been treated as discounts on the original prices of the cars. HMRC, however, refused the claim for repayment, on the ground that WPMC had not established that it had overpaid VAT.

WPMC was challenging the refusal by the FTT to draw conclusions based on the evidence under examination. Following *Pendragon* [2015] UKSC 37, the UT noted that WPMC's challenge could only succeed on the basis set out in *Edwards v Bairstow* [1956] AC 14. Therefore, a finding of fact by the FTT could only be set aside if it appeared that the finding had been made 'without any evidence or upon a view of the facts which could not reasonably be entertained'.

In order to deal with claims following the *Elida Gibbs* decision, HMRC had drawn up a table setting out the periods and manufacturers in relation to which evidence was available. One issue was the treatment of periods not covered by the table — the 'silent periods'.

Decision:

The UT held that the FTT had been entitled to take the view that changes in practice by individual manufacturers made it unsafe to infer that VAT had been accounted for in a silent period from the fact that it had been accounted for in another period. Additionally the UT rejected the assertion that the only reasonable inference on the facts of this case was that WPMC had accounted for VAT on all the bonus payments received by it.

Comments - This case confirms the limits of the jurisdiction of the UT in relation to findings of facts. It is also a reminder that the presumption that a state of facts established in one tax year will continue in the following tax years (*Jonas v Bamford* [1973] STC 519) can be rebutted.

Why Pay More For Cars v HMRC [2015] UKUT 468

Was a clubhouse a village hall?

Summary: The FTT found that the clubhouse of a sports club was a village hall.

The club had built a clubhouse. As the club was a charity, the issue was whether the clubhouse was used as a 'village hall in providing social or recreational facilities to the local community', so that the construction works were zero-rated.

Decision:

The funding application had suggested that the intended use of the clubhouse by the local community had been minimal. A witness for the club, which the FTT had found to be credible, had however indicated that 90% of the usage of the hall had been by clubs or groups other than Caithness Rugby Football Club.

Furthermore, a sporting facility was a recreational facility. And, in a rural area such as that of the club, the geographical size of the local community could be significantly larger than in an urban area. Therefore, the fact that a team from the nearby village used the club did not affect the position. Finally, parts of the village hall which were hardly used could still be treated as part of the hall for VAT purposes.

Comments - The case covers exhaustively each of the elements of the village hall exception, analysing the meaning of 'village hall', 'social or recreational activity' and 'local community'.

Caithness Rugby Football Club v HMRC [2015] UKFTT 378

Retrospective inclusion of a company into a VAT group

Summary - The FTT sent the case back to HMRC for it to reconsider yet again its policy on the retrospective inclusion of a company into a VAT group.

Copthorn was challenging HMRC's refusal to exercise its discretion to concede the retrospective inclusion of two group companies into its VAT group.

The dispute resulted from several errors made by various companies of the Copthorn group, as the result of which the group had suffered a forfeiture of a deduction for input tax in excess of £2 million. The mistakes had been caused by frequent changes of staff and HMRC accepted that the group had never intentionally excluded the two companies from its VAT group. In fact, Copthorn had mistakenly believed that the companies were part of the group.

In an earlier decision on the same matter ([2013] UKFTT 190), the FTT had found that the matter should be remitted to HMRC for further consideration. This was on the basis that the statutory power conferred on HMRC to backdate the inclusion of companies in a VAT group was a general and open discretion. Therefore, it was wrong for HMRC to have publicised a policy (*VAT Notice 700/2*) that prescribed the only limited circumstances in which it would exercise this power, thus altogether precluding backdating in all other situations. Copthorn now complained that the very minor changes made by HMRC to its official policy had not improved matters.

Agreeing with Copthorn, the FTT decided to remit the matter to HMRC for the following reasons:

- The mere inclusion of the word 'include', when the whole tenor of the policy remained unchanged, was a 'somewhat cynical endeavour' to leave the policy substantially unchanged.
- When a retrospective inclusion into a VAT group was designed to validate a group's pre-existing assumption that a company had been in the group and filings were made on that basis, the retrospective inclusion into the group would not necessitate any changes to the VAT returns.
- The policy required applicants wishing to backdate their application by more than 30 days to be able to show 'exceptional circumstances'. However, this type of mistake was common and therefore could not qualify as 'exceptional'.
- No examples of exceptional circumstances were given.

Comments - HMRC is in the embarrassing position of having to change its policy on retrospective inclusion in a group yet again. This time, the FTT has suggested that a distinction should be drawn between groups which simply 'change their minds' and those which have assumed that a particular company was a member of the group and have made all filings accordingly. Although retrospective inclusion should not apply in the first case, it should apply in the second. The FTT also recommended that HMRC 'pay some regard to fairness and common sense'.

Copthorn Holdings v HMRC [2015] UKFTT 405

Pre-registration input tax – have HMRC moved the goalposts? (Lecture B920 – 14.08 minutes)

Introduction - basic rules

A business can claim input tax on its first VAT return in relation to pre-registration expenditure if the following conditions are met.

- In the case of goods (stock or assets) they must be owned by the business on its first date of registration, and have been used in the business since acquired for the purpose of taxable supplies. The goods must have been purchased within the four year period before registration otherwise a claim is time barred.
- The time window for services is limited to six months before registration and the service cannot have been consumed before registration

Legislation – VAT Regulations 1995 – SI1995/2518, Reg 111.

However, HMRC amended their internal guidance in 2011 to revise their interpretation of Reg 111. This amendment has only recently come to light because it is well hidden in the guidance and there has been no amendment in HMRC's main public notices. The key question is: how much input tax can be claimed on that first VAT return?

Dave's stock and assets

Let me introduce you to Dave the decorator, who started trading in 2005. He traded below the VAT registration threshold until 31 December 2014, so registered on a compulsory basis on 1 February 2015 ie one month after exceeding the threshold. He owns the following items on 1 February 2015 when he registered for VAT:

- Van – bought for £10,000 + VAT on 1 February 2012
- Tools – all bought for £5,000 + VAT on 1 February 2013
- Office furniture - £2,000 + VAT purchased on 1 December 2009
- Computer – purchased for £500 from a friend – no VAT

He completed his first VAT return for the four-month period to 31 May 2015.

Dave can claim input tax on his first VAT return in relation to the van and tools but not on the office furniture that is denied by the four year time window that applies to goods. Input tax cannot be claimed on the computer because no VAT was paid on acquisition.

Note – do not forget that Dave can still claim input tax on pre-registration expenditure if he uses the flat rate scheme for the first period. He will also get 1% discount on his chosen flat rate category in the first 12 months of VAT registration.

So here is the dilemma: can Dave claim the full input tax of £3,000 on his first VAT return, ie the total VAT he paid when he bought the van and tools, or must he reduce his claim to reflect wear and tear and use in the business between February 2012 and February 2015 in the case of the van and one year less with the tools? Most advisers would have said £3,000 but HMRC think otherwise.

VAT legislation and guidance

The key document to highlight the 2011 change in policy is guidance note VIT32000 – see http://www.hmrc.gov.uk/manuals/vitmanual/VIT32000.htm.

To directly quote from the guidance:

"You must also take into account any use that has been made of the goods or services prior to registration. For example:

- A business that is trading below the registration threshold acquires a van;
- After three years the business registers for VAT. The van is still on hand at the EDR (*author note* – EDR means effective date of registration). The van has been used to make supplies that were not subject to VAT.

The amount of VAT that can be recovered under regulation 111 should reflect the use of the van for making supplies before registration."

So how does this work in practice? A typical van probably has a five-year life and I would guess that tools have a 10-year life expectancy. So on this basis, Dave should only claim £800 input tax on his van instead of £2,000 and £800 on his tools instead of £1,000 ie to reflect the pre-registration ownership period. So why did HMRC make this policy change back in 2011?

"An adjustment does need to be made for pre-registration use of goods," said a spokesperson for the HMRC press office, "because EU law states that VAT on goods is only deductible in so far as the goods are used for the purpose of taxable transactions. Regulation 111 of the VAT Regulations 1995 implements EU law and in that context it must be possible to part consume or use up goods to ensure both lawful deduction and equal treatment between registered and unregistered businesses. The need for equity of treatment is consistent with the ECJ's interpretation of EU law, see Lennartz C97/90."

I suppose it is reasonable that Dave should not claim all of the input tax on his tools and van because they have been used to generate a lot of sales where HMRC received no output tax. But the tax profession has always seen the opportunity to claim all of the VAT paid on relevant goods as a lawful incentive to help a new business faced with the challenges of being VAT registered for the first time.

The relevant EU legislation quoted by the press office is Article 289 of the VAT Directive (see below) and I have added some comments about the different wordings used by the EU capital of Brussels compared to us in the UK.

Article 289 of EC Directive 2006/112 (known as the VAT Directive or Principal VAT Directive):

"Taxable persons exempt from VAT shall not be entitled to deduct VAT in accordance with Articles 167 to 171 and Articles 173 to 177, and may not show the VAT on their invoices"

Note – in EU law, a 'taxable person' is a person undertaking any 'economic activity' (in business) whereas in UK law, a 'taxable person' is someone who is either registered for VAT or should be registered. The phrase 'exempt' under EU law means a sale that does not charge VAT ie including sales made by unregistered persons, compared to a sale that is 'exempt' from VAT in the UK under VATA1994, Sch 9. So Dave was a 'taxable person' who was 'exempt from VAT' between 2005 and January 2015 according to EU law.

Publicising the change

So when did HMRC change their guidance and why is the issue silent in VAT Notice 700/1 that deals with registration issues – and specifically para 5.2 which deals with pre-registration input tax claims? Notice 700 section 11 is also silent on the method of calculation.

"The vast majority of those asking us for advice understood some restriction to be correct and the guidance was made more explicit in 2011 to properly reflect the correct treatment. The HMRC public notice 700/1 will need to be updated," added the press office spokesperson.

So although Regulation 111 does not mention the need to restrict input tax on pre-registration claims, it would be ultra vires if it allowed claims that are restricted by Article 289.

As a separate issue, I discussed two past tribunal cases with HMRC that seemed to support an input tax claim based on the amount paid. The cases were *Wilf Gilbert Staff Ltd (*VTD2017) and *D Jerzynek* (VTD18767). I will not go into lengthy details but HMRC's response was that the Gilbert case supported their approach but 'the analysis at paragraph 8 is flawed' and that Jerzynek is a red herring because 'the VAT on the rent would have been attributable to exempt and not taxable supplies'.

What about services?

The extract I quoted from VIT32000 mentions a 'use' restriction in relation to services. Is it possible for a 'service' invoice to ever relate to the post-registration period because suppliers only usually raise an invoice when a service has been supplied? The good news is that the guidance note adds the sensible comment: "Six months represents a period in which it is deemed that services obtained will relate to business activity carried on at the time of registration." So if Dave's telephone bill was dated 31 Decem-

ber 2014 and related to calls and rental for the three month period from 1 October 2014, then it is acknowledged by HMRC that many calls will relate to contracts and issues relevant to his post-registration period ie when he will account for output tax on his jobs.

The type of service where they would expect an input tax block is where eg a subcontractor (VAT registered) is working for Dave on a job which Dave finished and invoiced before he registered ie no output tax is paid on the job in question so an input tax block is fair.

Conclusion – are HMRC right?

HMRC's approach seems to be supported by the reference to Article 289 in EU law. It gives a clear outcome to counteract the shortcomings in Regulation 111. At the time of recording this presentation, there has been no further announcement by HMRC on this issue, creating uncertainty for many advisers completing first VAT returns for clients who incurred pre-registration expenditure. As a planning point, there might be an argument for some new applications to seek a retrospective registration date (a voluntary registration can be backdated by a taxpayer up to four years) so that all input tax comes within a period of registration, or at least very close to when the expenditure was incurred ie to minimise any potential depreciation period.

Contributed by Neil Warren