Tolley®CPD

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Personal Tax

Employment income for services

Summary – The UT held that dividends paid by a company to a number of individuals for their employment with the main company were taxable as employment income because they were a reward for services.

The taxpayer company implemented three tax avoidance schemes. Under two schemes (plan 5 and plan 7), two new companies were set up and the employees of the taxpayer, who were also appellants, received part of their salaries in the form of dividends paid by the new companies. The third scheme (plan 2) involved the provision of cars by a new company to some employees.

The First-tier Tribunal had found that the payments of dividends under plans 5 and 7 related to the recipients' employment with the taxpayer and were a reward for services. They were therefore emoluments from employment. The tribunal found further that the cars provided under plan 2 had ultimately been funded by the taxpayer and were taxable benefits.

The taxpayers appealed, stating the First-tier Tribunal had erred in law. In particular, after the payments had been identified as dividends, they could not also be emoluments.

Decision

Lord Jones in the Upper Tribunal said the First-tier Tribunal had applied the correct test in relation to plan 5: what was the true source of the payments? Referring to *Hochstrasser v Mayes; Jennings v Kinder* 38 TC 673, he found that the payments had been, in substance, income from employment and were not dividends. Further, the decision in *CRC v PA Holdings* in 2012 provided the authority to focus on the character of the receipts in the hands of the recipients.

On plan 7, Lord Jones said the First-tier Tribunal was entitled to find that the participating employees were paid for the services rendered to the taxpayer company. They carried them out under a contract of service, rather than a contract for services.

Finally, on plan 2, the Upper Tribunal said the First-tier Tribunal had not explained its finding that the cars had been provided by the taxpayer company. Lord Jones therefore remitted this ground of appeal to the First-tier Tribunal to give reasons for rejecting the appeal.

The taxpayers' appeals on plans 5 and 7 were dismissed.

Comments – The history of the PA Holdings case illustrated that although there was a specific order of identification or hierarchy relating to the source of the income tested in the FTT and the Upper Tribunal Lord Justice Moses in the Court of Appeal had not given priority to one income tax schedule over another, but had simply identified the source of the income. Accordingly it was highly unlikely that the Tribunal would not follow PA Holdings logic.

James H Donald (Darvel) Ltd and others v CRC, Upper Tribunal

Decision on residence status needs to reheard at FTT

Summary – The Tribunal determined that the Glyn case needs to be returned to the FTT for re-determination as certain principles were not taken into consideration the first time around.

In 2005, the taxpayer, a British citizen, decided to emigrate with his wife from the UK to Monaco indefinitely.

In 2005/06, he had received a large dividend from his main UK company, the tax on which would have been about £5.5m had he remained resident in the UK. He also wished to stop working and change his lifestyle. He was married with three grown-up children and owned a property in London, which he kept while living in Monaco.

The taxpayer said he had a new way of life. He believed that he could make a limited number of visits to the UK and that retaining his UK home would not affect his claim to be non-UK resident. In 2010, he and his wife returned to the UK permanently and moved back into their London house.

HMRC said the taxpayer was dual resident because he maintained and returned to his UK home frequently while abroad. They assessed him to tax on the dividend.

The First-tier Tribunal allowed the taxpayer's appeal on the ground that he had been resident only in Monaco in 2005/06. The Revenue appealed to the Upper Tribunal, saying the First-tier Tribunal had failed to take into account relevant considerations.

Decision:

The Hon Mr Justice Richards in the Upper Tribunal said the First-tier Tribunal had considered several factors, many of which were relevant and significant, in particular whether the taxpayer had made a distinct break involving a substantial loosening of his family, social and business ties. It had also taken into account irrelevant factors, for example the purpose of the taxpayer's visits to London being to maintain family ties, and given insufficient consideration to some relevant ones.

The judge noted that the First-tier Tribunal had described the case as "borderline", but said that the errors of law it had made invalidated its decision. It was not a suitable case for the Upper Tribunal to rule on the issue of residence or non-residence and neither party suggested that it could do so.

The case was remitted to the First-tier Tribunal for rehearing.

HMRC's appeal was allowed.

Comments – We have seen this case a while ago when it went through the FTT and the borderline decision has been overturned. We will continue to see cases from the old rules because the lack of precision which is now available under the Statutory Residence Test. It is worth reminding oneself of old rules particularly as they will still be needed to determine deemed domicile (see the summary of the current consultation document later in HMRC News).

Glyn v CRC, Upper Tribunal

Was the PILON a contractual payment?

Summary – The Tribunal found that the payment was a contractual payment and therefore the £30,000 exemption did not apply

The taxpayer was dismissed from his employment without notice. Under a compromise agreement, he received a payment in lieu of notice including car allowance and pension contributions of £68,000. He also received back pay of £33,050 and holiday pay of £1,271. In his tax return, he claimed the exemption, under ITEPA 2003, s 403, for the first £30,000 of the £68,000.

HMRC said the exemption was not due. The taxpayer appealed.

Decision:

The First-tier Tribunal said the issue concerned the nature of the payment made under the compromise agreement rather than the fact the taxpayer had been made redundant.

The judge referred to EMI Group Electronics Ltd v Coldicott [1999] STC 803 which involved a similar situation. In that case it was held that the payment in lieu of notice was taxable as earnings even though it was made at the company's discretion. In this instance, the taxpayer's contract provided "simply for the company to have discretion to make a 'payment' in lieu of notice".

The judge said it seemed clear that "the total of the basic salary and the amounts in relation to the other benefits were intended to constitute the payment which the company was entitled to make in lieu of notice under … the contract of employment".

The taxpayer received the cash equivalent to the payments he would have received had he worked during the notice period. Finally, on the element relating to pension contributions, the judge said, because it was not paid into the pension scheme, it should be treated in the same way as the rest of the payment.

The payment was a contractual payment in lieu of notice and was taxable as earnings under ITEPA 2003, s 62. The exemption was not due.

The taxpayer's appeal was dismissed.

Comments – Termination payments have a complicated tax treatment and it is essential to work out exactly what are the components as the tax treatment will follow therefrom. In this case the Tribunal looked at what he would have received and what he did receive and concluded that the payment was contractual.

P Andrew v HMRC TC4672

Removal of the wear and tear allowance (Lecture P925 – 10.22 minutes)

From April 2016 the wear and tear allowance will end, to be replaced by a deduction for landlords when they actually spend the money. A consultation document has been released and any changes will be included in Finance Act 2016. Consultation closed on 9 October 2015.

Key aspects of the consultation document:

From April 2016 the Wear and Tear Allowance will be replaced with a relief that enables all landlords of residential dwelling houses to deduct the costs they actually incur on replacing furnishings in the property.

The relief will apply to landlords of unfurnished, part furnished and furnished properties. The relief will not apply to 'furnished holiday letting' businesses (FHLs) and letting of commercial properties, because these businesses receive relief through the Capital Allowances regime.

The new replacement furniture relief will only apply to the replacement of furnishings. The initial cost of furnishing a property would not be included.

Under the new replacement furniture relief landlords of all non-FHL residential dwelling houses will be able to claim a deduction for the capital cost of replacing furniture, furnishings, appliances and kitchenware provided for the tenant's use in the dwelling house, such as:

- movable furniture or furnishings, such as beds or suites,
- televisions,
- fridges and freezers,
- carpets and floor-coverings,
- curtains,
- linen,
- crockery or cutlery,
- beds and other furniture

HMRC believe that limiting the scope of the allowance to items that are provided for the tenant's use in the dwelling house that is being let removes any opportunity to claim the cost of larger items used for the purpose of the property rental business, for example, cars. It remains to be seen whether this particular point makes it through to FA 2016 as this seems particularly contentious.

Fixtures integral to the building that are not normally removed by the owner if the property was sold would not be included because the replacement cost of these would, as now, be a deductible expense as a repair to the property itself. Fixtures include items such as baths, washbasins, toilets, boilers and fitted kitchen units.

Landlords will no longer need to be concerned with whether the item being replaced is a fixture (and therefore a repair to the property) or not. In either case, the cost can be deducted from their rental income to arrive at the profits of their property rental business.

Landlords will no longer need to decide whether their property is sufficiently furnished to claim the new replacement furniture relief, as they had to when claiming the Wear and Tear Allowance. This is because the new relief will apply to all landlords of residential dwelling houses, no matter what the level of furnishing.

The new replacement furniture relief will be for expenses that are actually incurred by landlords, rather than an arbitrary percentage. The value of the relief will no longer be dependent on the location that the property happens to be in and the local rates of rent. It will provide a better incentive for landlords to actually maintain the furnishings in their property. They will not be able to claim any relief without actual expenditure.

To ensure that the relief mirrors, as closely as possible, the landlord's economic position, the new replacement furniture relief will give relief for the cost of the replacement asset, less any proceeds received from the old asset that is being replaced.

In line with the policy that relief for the initial cost of assets will not be given, any element of the replacement asset that represents an improvement would be excluded from the new replacement furniture relief. The replacement will include an improvement if the new asset can do more or if it can be used to do something that it could not do before. For example, replacing a washing machine with a washer-dryer is an improvement. If the washer dryer cost £600, and the cost of buying a new washing machine like the old one would have been £400 then the replacement furniture relief will be £400 (£600 less the £200 that represents the difference in cost between a washing machine and the washer dryer).

Comments – Landlords should not be replacing free standing white goods, furniture, carpets, curtains etc in 2015/16 unless absolutely necessary. The only time a landlord will get a deduction for replacement of these items in 2015/16 will be if the items were damaged beyond repair in a partly or unfurnished property. The emphasis of the replacement spend is therefore "repair" and it would be deductible. If the same items was being replaced simply because it was old then the replacement is not deductible as the renewals basis was scrapped in April 2013.

For furnished properties the wear and tear deduction covers replacement of these items so there would be no specific deduction for money actually spent in 2015/16.

If free standing white goods, furniture, carpets curtains etc are replaced in 2016/17 the replacement cost will be deductible in all cases.

Article by Dean Wootten

Planning for the new buy to let interest regime (Lecture B922 – 13.33 minutes)

From April 2017, tax relief on interest in property businesses (including single buy to lets) will be restricted so that by 2020, interest will not be an allowable expense in computing the profits of the business, but will attract tax relief at 20%. The change does not affect furnished holiday lettings. The change will be phased in as follows:

	2017/18	2018/19	2019/20	2020/21
% of interest allowed as a deduction	75	50	25	0
% of interest given as a relief at 20%	25	50	75	100

This change will have a significant impact for buy to let clients and those with high gearing should consider incorporating their property portfolio before April 2017. This will entail forming a new company and then selling their buy to let portfolio to the company in return for shares in the newly incorporated company.

Key issues for the incorporation of a property business would be as follows:

1. Finance

Early discussion with the current lenders is essential. This may cause practical issues such as lenders not willing to lend to a company, high arrangement fees and favourable current mortgage terms not being matched in the new company.

2. Capital Gains Tax

All the properties will be transferred to the company at current market value which will create a capital gain in many cases. This gain could be set against the value of the shares if incorporation relief is available under s.162 TCGA 1992.

If the consideration given by the newly incorporated company is not wholly satisfied by the issue of shares, there will be a pro-rata restriction of the s.162 relief. The assumption of bank debt is not regarded as consideration – HMRC accept that bank debts were business liabilities and hence covered by ESC D32.

The 2013 Upper Tribunal decision in Ramsey provides good authority for treating a substantive property letting activity as a business for s.162 purposes. In Ramsey, the Upper Tribunal ruled that activities ordinarily associated with managing an investment property portfolio can be regarded as a business.

However, in order to be treated as a business undertaking for s.162 purposes the activities must:

- represent a seriously pursued undertaking;
- be conducted on sound and recognised business principles; and
- be of a kind that are commonly made by those that seek to profit from them.

Furthermore, the activities must have a degree of substance with a reasonable amount of time being spent on property related activities. Mr and Mrs Ramsey owned a residential block with 10 flats. They spent about 20 hours a week attending to the building, making sure the rent was paid on time, cleaning communal areas, forwarding post to tenants who had left, and ensuring the property was insured and complied with fire regulations. This level of activity convinced the Upper Tribunal that Mr and Mrs Ramsey had a property business for the purposes of s.162. It would be reasonable to assume that a property portfolio of one or two properties with minimal management time will not satisfy the test.

On the other hand, if a client has 20+ properties and spends in excess of 20 hours a week managing their property business they should have no problems securing s.162 relief. It should be noted that the key factor is time spent rather than number of properties. I would also argue that the time spent could be undertaken by a property manager but HMRC may take a different view!

3. SDLT

S.53 FA 2003 imposes an SDLT charge on the market value of property where it is transferred to a company and the seller is connected to the company or some or all of the consideration consists of the transfer of shares in a company with which the seller is connected. The connection test in s.1122 CTA 2010 applies for s.53 purposes.

Under s.1122 CTA 2012 the following persons are treated as connected with you:

- your husband, wife or civil partner
- your brother, sister, ancestor or lineal descendant ("relatives") and their husbands, wives or civil partners. Relatives do not include nephews, nieces, uncles and aunts.
- your husband's wife's or civil partner's relatives and their husband's wives or civil partners
- if you're in business in a partnership, your partners and their husbands, wives, civil partners and relatives. Business partners will not be connected in relation to acquisitions or disposals of assets of the partnership pursuant to genuine commercial arrangements.
- a company that you control, either by yourself or with any of the persons listed above, or
- the trustees of a settlement of which you are a settlor , or which a person who is still alive and who is connected with you is a settlor.

An incorporation of a property portfolio will undoubtedly fall under s.53.

However, where the transfer is under the partnership SDLT legislation, HMRC accept that the partnership "sum of lower proportion" rules take precedence over s.53. Depending on the facts this can result in the consideration being regarded as £nil and as a consequence **no SDLT** is due on incorporation (FA 2003, Schedule 15, Para 18 – 20).

Schedule 15, Para 18(2) will apply where a chargeable interest is transferred:

- from a partnership to a person who is or has been one of the partners, or
- from a partnership to a person connected with a person who is or has been one of the partners

Para 18(2) states that the chargeable consideration shall be taken to be equal to:

MV x (100 – SLP)%

Where….

- MV is the market value of the interest transferred, and

- SLP is the sum of lower proportions.

Schedule 15, Para 20 provides the detail in calculating the sum of lower proportions.

Essentially we need to identify partners (and their connected persons) who continue to own an interest in the property after the transfer. For each relevant owner we need to find their % in the property after the transaction and then add them all together to find the SLP.

Where the property partners are connected to each other, by way of marriage for example, they are treated as one for these purposes. Their new company will be a connected person as it is controlled by them. As the company owns 100% of the properties post incorporation, the SLP is 100%. Consequently the chargeable consideration on incorporation is £nil i.e MV x (100 – 100)%.

The key is that no interest has effectively changed hands – the ownership of the property is still by the same persons – albeit connected.

It is important that the partners are connected to each other by way of s.1122 e.g. marriage, as this then brings in their company as this is a company they control.

If the partners are unconnected by marriage or blood, they will have to rely on s.1122(4) to secure a connection i.e. "any two or persons acting together" to secure the sum of lower proportions treatment. Business partners are not automatically connected persons when dealing with acquisitions or disposals of assets of the partnership pursuant to genuine commercial arrangements.

Partnership?

One very important issue is whether the properties are held in a partnership or simply owned in joint names. To have access to the partnership SDLT rules you must be operating as a partnership and this is a question of fact.

Key issues to consider would be as follows:

- Is there a written partnership agreement?
- Have the partners actually been carrying on the business together with a view to profit?
- Has a partnership tax return been submitted to HMRC?
- Is there a partnership bank account?
- Are the partners held out as partners to the outside world?
- Does the partnership enter rental agreements and raise rental invoices in the name of the partnership?
- Have partnership accounts been prepared?
- Do the partners share profits and losses?
- Have the partners contributed capital to the partnership?
- Is business stationery in the partnership name?

If a partnership does not exist then the s.53 FA 2003 market value rules will apply on incorporation.

It is also important to be aware of the SDLT general anti-avoidance rules within s.75A FA 2003 where steps have been taken to deliberately use the partnership rules to obtain an SDLT advantage. This might entail moving a property portfolio into an LLP with a view to incorporating within a short period of time. Where a partnership is not currently in existence, it may well be prudent to move a portfolio into an LLP and then sit tight for a while. The incorporation option may well be discussed at a later stage but it is by no means certain at the point an LLP is formed.

Article by Dean Wootten

New pension freedom and lifetime allowance (Lecture P922 – 10.44 minutes)

The lifetime allowance determines the level of tax privileged funds within your pension pots and from 6 April 2016 it is being reduced from £1.25m to £1m. Any excess fund could be liable to a 55% tax charge and so it is important that we know when and how to calculate the value of our pension fund.

Example

In 2016/17 Sachin retires and has a defined contribution fund of £400k. He also has a final salary pension, which gives him a tax-free sum of £130k, plus an annual pension of £19k.

The total value of his pension pots is £910k which is made up of his defined contribution fund of £400k plus his final salary scheme lump sum £130k and the value of his final salary pension of £380k (£19k x 20). For final salary schemes we apply a fixed multiple of 20 to the post lump sum annual pension. The funds are within the £1m lifetime allowance and so full tax privileges are available.

Testing the lifetime allowance

Whenever you take benefits from your pension pots you use up a percentage of your lifetime allowance and each occasion is known as a benefit crystallisation event (BCE).

So in our example, Sachin has used 91% of his lifetime allowance (£910k value of his £1m lifetime allowance) and his pension provider will provide Sachin with a certificate confirming that 91% of the lifetime allowance has been used and that he has a further 9% remaining.

Sachin could carry on working and contributing to a new defined contribution fund but he only has 9% of the lifetime allowance left. It is still worth contributing for the 40% tax relief on contributions but he needs to ensure that the fund does not breach 9% of the lifetime allowance that is applicable at the next BCE.

When do you have a BCE?

This next event could occur in a number of ways and include:

- Flexi access drawdown contract with 25% taken as a tax-free lump sum and the remainder put into a crystallised drawdown fund ready to draw as pension income.
- Each draw of income from an Uncrystallised Pension Lump Sum contract
- Taking an annuity: Tax free cash, balance to buy an annuity
- Starting to receive tax free cash and/or pension from a final salary scheme
- Reaching 75 with uncrystallised funds

- Reaching 75 if the value of the crystallised fund is higher than they were when they initially crystallised. This is to prevent taxpayers taking their 25% lump sum on 55 and letting the crystallised funds grow. A BCE will arise on the growth in crystallised funds at 75.

- Dying before 75 without taking benefits

Example: Lifetime allowance exceeded

Let's assume that the funds are worth £1.2m on a BCE when the lifetime allowance is £1m, giving an excess is £200k. There are two options:

1. Lump sum option where the administrator deducts 55% and so the taxpayer receives £90k of the £200k.

2. Income option where the administrator deducts 25%. The remainder is treated as income when drawn which will normally to equates to an effective 30% rate on income drawn i.e. 75% of the fund is ultimately taxed at 40%. The 25% original deduction plus the 30% on subsequent draws equates to a total tax rate of 55%.

However, if you adopt option 2 and were to die under 75 leaving your fund to a nominated beneficiary, then the remaining income left to the nominated beneficiary is tax free. Hence the effective rate would only be 25% i.e. the original deduction.

2016 protection

With the £1m reduction comes Fixed Protection 2016 where the taxpayer is able to keep the £1.25m limit but no further contributions are allowed after 5 April 2016. In these cases it is important to maximise contributions before 5 April 2016.

Alternatively, under Individual Protection 2016, if the funds are worth more than £1m at 6 April 2016 you can preserve that value and future contributions are allowed. If the fund fell in value, you would then look to make additional contributions to maximise your enhanced lifetime allowance.

Similar protections were available when the allowance decreased from £1.5m to £1.25m in 2014.

Article by Dean Wootten

Capital Taxes

Ordinary Residence status confirmed

Summary – The Tribunal concluded that the ordinary residence status continued at the point the sale of shares was made

The taxpayer had been living and working in the UK and was resident and ordinarily resident for several years before 2010/11. In January 2011, he took a sabbatical from his employment to work in Rwanda. In December 2011 his employment was terminated and he sold his employee shares to the employer.

In his 2010/11 return, the taxpayer claimed split year treatment under extra statutory concession A11. In his 2011/12 return, he claimed a capital loss of £145,827 on the sale of his shares against his employment income for that year (ITA 2007, s 131 and s 132). He also stated he was not resident and not ordinarily resident in that year.

HMRC refused the claim. The taxpayer appealed.

Decision:

The First-tier Tribunal said the taxpayer had ceased to be a UK resident in January 2011 but ceased to be ordinarily resident in the UK in December 2011. He had agreed with his employer to take unpaid leave while he decided whether he could make a life in East Africa. He had retained his shares and continued to own a home in the UK. However, in December 2011, he cut his ties with the UK when he left his employment and sold his shares. He had retained his UK home, but this was not sufficient to make him UK resident.

Noting that it was unusual for someone to be ordinarily resident when he was not UK resident, the tribunal said there was no reason why this should not happen. The legislation took account of this at TCGA 1992, s 2 and s 16.

As a result of ceasing to be ordinarily resident during part of 2011/12, the loss was allowable for capital gains tax.

The taxpayer's appeal was allowed.

Comments – Although the case is set around the loss relief in capital taxes the area of residence and ordinary residence is one which impacts on all personal taxes. Many practitioners would not have come across a circumstance where an individual was not resident but remained ordinarily resident although this permutation was illustrated by HMRC in their matrix in guidance. The case is of course of historic interest as the concept of ordinary residence disappeared from the legislation with the introduction of the Statutory Residence Test in April 2013.

M Carey v HMRC TC4634

PPRR allowed

Summary – The Tribunal found in favour of the taxpayer and consequently PPRR was allowed

The taxpayer claimed private residence relief under TCGA 1992, s 222 and lettings relief under s 223(4) on the disposal of his London flat in November 2009. He had bought it in March 2006 and occupied it during August and September 2006. The flat was let from December 2006.

HMRC refused the private residence relief claim. The taxpayer appealed. It was common ground that, if private residence relief applied, lettings relief would also apply so that the gain was fully relieved and vice versa.

The taxpayer offered several reasons why the flat was his home. These included that his business was in London and the flat was bought to replace his previous main residence. He also had a parking permit for the flat and had no other property that could have been his residence in that August and September.

Decision:

The issue before the tribunal was whether the flat had been the taxpayer's private residence. The First-tier Tribunal accepted that the nature, quality, length and circumstances of the taxpayer's occupation of the flat made it qualify as residence for the purposes of s 222 and s 223. The judge concluded that, because the taxpayer had no other residence during the relevant period, the flat was his only residence. Private residence and lettings relief were therefore available on the sale of the property.

The taxpayer's appeal was allowed.

Comments – TPPRR cases come up on a frequent basis before the Tribunal. In most cases it is an easy decision for the Tribunal in favour of HMRC. This case appeared to be a genuine case where there was a borderline decision. It also emphasises how important the evidence can be to helping the taxpayer’s case.

R Dutton-Forshaw v HMRC TC4644

Late amendments on The IHT Nil Rate Band (Lecture P923 – 13.37 minutes)

The new IHT residential Nil Rate Band (RNRB), which applies where an individual’s home is inherited on death by lineal descendants, was announced in the Summer Budget and included at clause 9 of the Finance Bill issued on 15 July (as the time of writing, the Bill is expected to receive Royal Assent in the next few days).

Note that during September there were three amendments to the drafting announced during the passage of the Bill at Committee stage.

These cover:

- Homes placed into trust on the first death for the surviving spouse will benefit from relief on his or her death
- A change to the definition of a foster parent to include similar terms, such as kinship carers in Scotland.
- Where the deceased leaves the home to the spouse of a direct descendant relief will be available

The problem

As originally drafted, RNRB relief was only available on a home owned at death i.e. not on one given away in lifetime, and so pre death planning was unavailable.

The inevitable result would follow that, to take advantage of the relief, parents would be discouraged from selling the family home and so continue to own an unnecessarily large home until death. This deliberate decision not to downsize would in turn as a result impede the property market.

Clearly the Government had not given itself enough time to think through this example of the law of inevitable consequence because the Bill when published contained no relieving measure.

Downsizing relief

Good news then came in the form of an HMRC announcement on 18 September: relief 'will also be available when a person downsizes or ceases to own a home on or after 8 July 2015 and assets of an equivalent value are passed to direct descendants.

The detailed on how downsizing relief might operate is contained in an HMRC technical note issued on 18 September and updated 8 October.

What are the qualifying conditions for downsizing relief?

The deceased must have either:

- Downsized to a less valuable residence or
- Sold their only residence or
- Otherwise ceased to own their only residence

….but in each case it must also be shown that assets equal in value to 'lost' RNRB has been left on death to lineal descendants.

In addition, downsizing must take place after 8 July 2015 – but any number of downsizing moves is thereafter permissible.

One other point to note is that the guidance refers to the 'only' home in contrast to the main FA 2015 provisions that clearly envisage the situation where the deceased may own more than one. Clearly we can expect the downsizing provisions to apply more narrowly.

Example 1- widow

The first relates to a widow who sells a home for £400k August 2020 and moves to a home worth £210k. At the time, we know from the FB 2015 provisions that the RNRB will be £175k per person

So her available relief is £350k which comprises her relief of £175k plus £175k transferred from her husband – we are clearly to assume that his relief was not used by his executors.

In the absence of downsizing provisions (and assuming unchanged property values prior to her death) her executors are looking at a potential loss of relief of £140k i.e. £350k less £210k

In the event she then dies a couple of months later leaving her property and other assets to her children. The property has in fact risen in value to £225k and is of course available for RNRB relief. It is also evident that the other assets contain the capital released from downsizing with the result that a further £125k relief is available to make a total of £350k

Making the further assumption that her husband did not also use his main NRB exemption of £325k and that this can be transferred to his widow, then a total relief of £1m is available resulting in no IHT liability on her estate

The total of £1m does of course comprise the main NRB of £650k plus the RNRB of £350k

Example 2 - widower

A widower (with available transferable NRB £650k and RNRB £350k) owns a home worth £400k which in May 2020 he gives to his children, then moving into rented 'later living' accommodation. In doing so he has potentially lost the chance to use £350k or 100% of the available RNRB which could have applied had he not given away his home.

When he dies in February 2021, within 7 years of the gift, he leaves his estate of £600k to his children.

The position for the gift of the house is considered first. RNRB only applies to the assets in the death estate, so it is not available in respect of the gift of the house. However, the estate can claim the full transferable NRB of £650k so there is no tax to pay on the gift of £400k. The balance of £250,000 TNRB remains available to be set against the estate.

The downsizing rules now allow RNRB to be applied against the estate of £600k leaving a remainder of £250k.The balance of TNRB from his late wife's estate is applied to this amount so no tax is payable as a result of the death.

Conclusion

The technical note invited comments and subject to these we can expect to see the changes recommended by the note to be included in the draft 2016 Finance Bill clauses to be issued in early December.

The combination of the changes in FA 2015 and 2016 will without doubt add additional complexity to the tax system.

As a result of the September announcement the term 'residential' NRB does in fact become misleading to a large extent. The examples in the technical note make it quite clear individuals do NOT in fact need to own a property on death to benefit.

By not linking the new RNRB to the value of the deceased's property on death, or within a defined period of death, the new proposals appear a means of enhancing the NRB on the overall estate for taxpayers with children, but not for those without. Many would consider this an unsatisfactory result.

Article by Brian Ogilvie

Flip flop Mark II scheme works

Summary – The Tribunal found that the scheme worked although this has been subsequently overtaken by legislation

The taxpayers, a brother and sister, were resident and domiciled in the UK. They were beneficiaries of an offshore discretionary trust created by their father in 1969. The sole trustee was a Guernsey company. Another discretionary trust was set up in 2002, also with the taxpayers as beneficiaries.

It was decided to implement a flip-flop mark II scheme. The assets of the 1969 trust were sold and the proceeds used to buy £4m worth of gilts. The trustee of the 1969 trust used the gilts in April 2002 as security to borrow £3.8m, which was paid to the trustees of the 2002 settlement. Those trustees made distributions to the taxpayers of £2.4m.

In May 2002, the trustee of the 1969 trust sold the gilts and repaid the loan.

HMRC ruled that, under TCGA 1992, s 97(5), the capital payments received by the taxpayers should be treated as if made from the 1969 trust, not from the 2002 settlement.

The First-tier Tribunal dismissed the taxpayers' appeal and they took the case to the Upper Tribunal.

Decision:

The Hon Mr Justice Barling in the Upper Tribunal said the natural effect of indirect receipt in TCGA 1992, s 97(5)(a) was that a beneficiary was still taken to have received a payment from a settlement even if it was paid to him through an intermediary. A separate settlement could constitute such an intermediary, but the payment would not in those circumstances be treated as "made by" and "received from" that intermediary for the purposes of the legislation.

He said the First-tier Tribunal had erred in holding that TCGA 1992, s 97(5)(a) permitted the same capital payment to be treated as having been "received from" the trustees of one settlement directly and from the trustees of another settlement indirectly.

On whether the payments were from the 1969 or 2002 trusts, the judge said it was clear they had been from the latter. It was true that the scheme had envisaged virtually all the transferred property being paid to the beneficiaries of the 2002 trust and that both sets of trustees had knowingly implemented the scheme, but this did not change the fact that the original trust's settled property had been transferred

to the new one. As a result, when the 2002 trustees made the capital payments, they did so entirely at their discretion.

He considered it impossible, taking a realistic view of the facts, to consider the 2002 trust "as a mere intermediary in the sense that would be necessary if the distributions were to be treated as received from/made by the 1969 trust indirectly".

The taxpayers' appeal was allowed.

Comments – This decision is now of historic interest but demonstrated how the scheme worked until it was overtaken by legislation. It is an illustration of how legislation worked differently being specific so that steps could be created to sidestep the legislation rather than the rounded use of wording in today's legislation.

C and J Bowring v CRC, Upper Tribunal

Entrepreneurs' relief restrictions after FA 2015 (Lecture P922 - 16.25 minutes)

Stringent 'trading company/group test for ER

The 'trading company/trading group' requirements have been 'borrowed' from the business taper rules. A company/group therefore qualifies provided it exists *wholly* for the purpose of carrying on one or more trades (on a commercial basis), subject to the disregard rule for insignificant non-trading activities.

A company is permitted to have *non-trading activities* provided they do not have a *substantial* effect on the company's overall activities.

HMRC take the view that non-trading activities may be regarded as 'substantial' if they represent more than 20% of the company's business. In marginal cases, the 20% test will be applied to various measures, such as turnover, profits, assets employed, management time etc.

'Transparent' treatment of joint venture companies (pre-18 March 2015)

Before the FA 2015 changes, holdings of 10% or more in qualifying joint venture (JV) companies were effectively treated as 'transparent' for the purposes of the ER 'trading company/trading group' test. This meant that the relevant (shareholding %) share of the JV's (trading) activities could be attributed to the investing company/group. The actual holding of the shares in the JV company was disregarded.

For these purposes, a qualifying JV company was one where *no* more than five persons held 75 per cent or more of its ordinary share capital.

These deeming rules were sometimes exploited where a company was not able to provide the 5% level of equity required typically for its key directors/managers'. In such cases, a 'management company' was set up by the management shareholders, which held a minority interest in the main trading company.

This was treated as a qualifying JV and hence the management team could access ER via their 'management company'.

FA 2015 treatment of joint venture companies

From 18 March 2015, a new s169S (4A), TCGA 1992 disapplies the 'transparent' rule for JV companies. This means that any qualifying shareholding in a JV company is treated in the same way as any other 'minority' equity investment.

This might affect the 'trading status' analysis for ER purposes, depending on the application of 'first principles' to the precise facts of each case. This would include, for example, the nature and size of the activities carried on by the investing company itself (and any fellow 51%+ group members).

Dividend income received from such holdings would normally represent 'investment income' in the investing company's hands for the purposes of this analysis.

FA 2015 – ER treatment of corporate partners

The new s169S (4A), TCGA 1992 (Inserted by s43 (2), FA 2015) states that

'In determining whether a company which is a member of a partnership is a trading company, activities carried on by the company as a member of that partnership are to be treated as not being trading activities…'.

The same rule also extends to cases where members of a 51%+ group act are partners of a partnership. LLPS are treated in the same way as partnerships for these purposes.

Overview of 'associated disposal' rules

Where an owner-manager/shareholder/partner qualifies for ER on the disposal of their shares/partnership interest, they may claim 'associated disposal' relief on any related-disposal of assets held by them directly which have been used in the company's/partnership's trade.

Associated disposal ER is only available if the relevant asset (typically property) has been used in the company's/partnership's business for at least 12 months before the main disposal of shares.

For shareholders, the disposal of the personally held asset must take place as part of their 'withdrawal from participation' in the business. This term has never been precisely defined and in practice HMRC have normally been prepared to treat this rule as having been satisfied in relation to share disposals of any size.

FA 2015 tightening-up of 'withdrawal from participation' rule

Section 41, FA 2015 introduced a more stringent 'withdrawal from participation' test. From 18 March 2015, the shareholder must dispose of shares that comprise at least 5% of the ordinary share capital (carrying at least 5% of the voting rights) of the company (s169K (1B), TCGA 1992).

Furthermore, there must be no 'share purchase arrangements' within s169K (1E), TCGA 1992 – broadly 'arrangements' under which the shareholder can purchase shares in the same company/group company etc.

If the share disposal is being made via a capital distribution, the 'associated disposal' ER is now only given on the dissolution or winding up of the company (s169K (1C), TCGA 1992).

Similar rules apply to partnerships.

Contributed by Peter Rayney

SDLT when incorporating a property portfolio (Lecture B921 – 19.51 minutes)

SDLT basics

Stamp duty land tax (SDLT) is levied on the acquisition of a chargeable interest for a chargeable consideration (FA 2003, s 43).

This means that SDLT is payable not only on the 'normal' purchase of UK land land but also on the creation, release, surrender, or variation of a chargeable UK land interest. This clearly includes the grant of a lease, which is subject to special rules. SDLT is also charged on the value of any fixtures substantially attached to the land under land law. Items that retain their character as chattels and moveable property will not be charged to SDLT.

Broadly, SDLT is payable on the 'completion' of a land transaction by the purchaser (FA 2003, s 42). However, the SDLT charge is brought forward where a land transaction is 'substantially performed', such as where a substantial (90%) amount of the consideration is paid (which includes the first 'rent' payment on a lease) or where the purchaser takes possession (for example, occupation).

SDLT is payable by the purchaser (or lessee).

If the property is subject to standard rate VAT (including where an option to tax has been made), then SDLT would be levied on the VAT inclusive price.

Residential v non-residential property

Different SDLT scales apply to residential property and non-residential/'mixed-use' property. Since 4 December 2014, the SDLT on each type is now calculated differently. Residential property uses the 'slice' basis of calculation with the 'slab basis' being retained for non-residential/mixed-use property.

Residential property includes buildings that are used or are suitable for use as dwellings, their accompanying gardens and grounds, and residential accommodation for school pupils and students (other than those in higher education) (FA 2003, s112 to s119).

The status of a residential house or flat is normally clear-cut. In HMRC's view, the status of the property is based on its use at effective date of the transaction. This overrides any past or intended future use. However, where an unused building was last used as a dwelling, it is generally taken to be 'suitable for use as a dwelling' in the absence of any contrary evidence. Similarly, an existing building is treated as a dwelling if it is being adapted or marketed for, or restored to, domestic use (see HMRC SDLTM 29900).

An important deeming rule applies to the transfer of six or more dwellings in a single transaction, which treats them (collectively) as 'non-residential' for SDLT purposes (FA 2003, s116 (7)). This means that the SDLT rate is normally limited to 4% (the maximum rate for commercial buildings).

The SDLT rules relating to residential properties are not covered in this webinar.

VAT transfer of going concern treatment for property rental businesses

Since SDLT is calculated on the VAT-inclusive price, the purchase will save SDLT if the transaction can be brought within the VAT 'transfer of going concern' (TOGC) rules. If TOGC relief is available, it is outside the scope of VAT and thus no VAT is payable.

A sale of a property rental business would qualify as a TOGC if it meets all the relevant conditions. In particular, the purchase must opt to tax the property/properties and notify HMRC of that option before the VAT supply is made.

Normally the freehold sale of a fully or partially let property will qualify for full TOGC relief. On the other hand, the sale of property to a sitting tenant would not qualify as a TOGC (since the letting business ceases).

The 'linked transactions' rule

Broadly, linked transactions are those made as part of a single scheme or arrangement between the same seller and same purchaser (or their 'connected' parties).

If the transaction is linked, the rate of SDLT is fixed by reference to the total consideration for all the linked chargeable land transactions [s55 (4), FA 2003].

SDLT charge on property transferred to 'connected' company

As a general rule, there is no deemed market value SDLT charge where property is transferred for no consideration.

However, there is an important exception to this rule in s53 FA 2003 which imposes a deemed market value charge where property is transferred to a company AND

- The seller is connected with the company; OR

- Some or all the consideration consists of the transfer of shares in a company

with which the seller is connected.

The ''connection' test in s1122 CTA 2010 is used for these purposes.

However, where the transfer is taxed under the partnership SDLT legislation, HMRC accept that the partnership SDLT rules takes precedence (see HMRC SDLTM34170). Depending on the facts, this may lead to a smaller or indeed 'nil' SDLT liability.

SDLT charge on transfer of property from a partnership to company

Under the complex SDLT partnership provisions, an SDLT charge arises where a partnership transfers a property interest to a person who is or has been one of the partners. Broadly, the chargeable proportion is the part attributable to the shares of the remaining (unconnected) partners. The formula – MV x (100% less SLP%) = proportion of MV of property charged to SDLT on transfer from the partnership to a partner. However, where the partners are 'connected' with each other within s1122 CTA 2010 (except as business partners under s1122 (7) CTA 2010), the SLP will be 100%.

Example – SDLT on incorporation of a 'family' partnership

Assume Ray & Dave are related (by a blood relationship). Under this analysis, the SLP% would be 100% (being the amount held by them and their 'connected' company). Thus, under the partnership SDLT rules (see para 18, Sch 15, FA 2003), no SDLT should arise on the transfer of the partnership property to the company.

In the case of a non-family partnership, there might be a potential argument that the partners are connected with each other under s1122 (4) CTA 2010.

SDLT general anti-avoidance rule in s75A FA 2002

It is always important to consider the SDLT general anti-avoidance rules in s75A FA 2003 where steps have been taken to deliberately use the partnership rules to obtain an SDLT advantage.

Contributed by Peter Rayney

Administration

Reasonable excuse for only part of the time

Summary – The Tribunal determined the reasonable excuse was only valid for part of the time.

The taxpayer appealed against penalties imposed by HMRC for the non-submission of the 2010/11 form P35. The First tier Tribunal noted that the taxpayer had failed to submit the 2009/10 return, but no penalties were imposed because HMRC had adopted a policy of mitigating penalties for that year. A "reasonable taxpayer would have anticipated having to make an online return" for 2010/11, but she did not contact HMRC until several days after the deadline (19 May 2011) to say she did not have the correct passwords to file online.

From that time, the taxpayer tried to comply. After contacting HMRC, she was told to submit the form on paper which she did in July. The tribunal noted that the taxpayer believed the form had been accepted, even though it was not in the correct online format. But after HMRC contacted the taxpayer in December to inform her that the form was not in the appropriate format, she "must have been aware that HMRC were no longer treating the information … as being acceptable".

Decision:

The judge considered whether it would be possible to take the view that, once the taxpayer "had been given the expectation that she would be treated as having filed her form P35 correctly, she should be treated as having a reasonable excuse even after HMRC acquainted [her] of its change of view". That might be fairer, but "such an approach would trespass too far into the realms of reviewing the fairness of HMRC's actions". After the decision of the Upper Tribunal in *Hok Ltd*, this was deemed not to be within the jurisdiction of the tribunal.

On this basis, the tribunal said the taxpayer had a reasonable excuse for not filing online between July and December only.

The taxpayer's appeal was allowed in part.

Comments – It is crucial for complete reliance on the concept of reasonable excuse that the cause is rectified as soon as possible or the reasonable excuse lapses. This therefore meant that the reasonable excuse was only valid between July and December.

M Walker v HMRC TC4646

Reading the T&Cs is burdensome

Summary – The Tribunal found that the mandate of ticking the box on the government gateway was not within the power of HMRC

The taxpayer was a barrister and was prepared to file his VAT returns online. However, he refused to tick a box on the government gateway to confirm he had read HMRC's terms and conditions for online filing. As a result, he had to submit paper VAT returns in 2012 and 2013 because, without ticking the box, he could not submit online returns. HMRC imposed a penalty for not filing online.

The taxpayer appealed, saying HMRC had no legal basis for requiring him to read the terms and conditions and therefore the penalty was unlawful. He did not object to any specific term or condition because he had not read them. He objected to the imposition of any conditions and also the number of them, saying they would be burdensome to read.

A printed copy of the terms was presented to the First-tier Tribunal. It amounted to more than 12 A4 pages of "fairly close print", although about one-third applied to individual taxpayers.

Decision:

The tribunal said that "the terms and conditions went beyond being a recital of the law". After considering the legislation, the judge said nothing in FA 2002, s 135 "mandatory e-filing" envisaged that HMRC would impose an obligation to file online while at the same time making it a "precondition of a taxpayer doing so that he had to tick a box to say he had read conditions HMRC chose to present as binding".

Section 135(2)(a) gave HMRC the power to set out the form of the return in regulations, but they did not exercise that power. Indeed neither the form nor the requirement to tick the box was in the regulations.

The judge concluded: "HMRC made it compulsory for taxpayers to tick the terms and conditions box before they could use the government gateway to file their online VAT return. So while it is true that this pre-condition, firstly, did not import any liability on the taxpayer as it was not binding in law and, secondly, was largely but not entirely rather innocuous, nevertheless HMRC had no power to impose it at all." The taxpayer's appeal was allowed.

Comments - Neil Warren, independent VAT consultant, commented: "Very few people read the terms and conditions of websites – whether it be in relation to completing online VAT returns or buying theatre or sporting tickets. So the taxpayer was being honest in refusing to tick the box and his comment that reading them would have been 'burdensome' seems to have been well received by the tribunal chairman. It is hoped that HMRC will take account of the court's findings and revise their terms so that they are less onerous." We shall have to wait and see if HMRC take the point made in the last line by Neil Warren.

Neil Garrod v HMRC TC4537

Reduced penalties because of limited reasonable excuse

Summary – The Tribunal found that the reasonable excuse lasted for only part of the period

HMRC imposed penalties on the taxpayer for the late filing of his self-assessment tax returns and late paid tax. The taxpayer appealed. He had received P800s for the tax years 2008/09 to 2011/12 inclusive. They showed that he had underpaid tax because his employers used a BR tax code which led to income that should have charged to tax at 40% only being taxed at the basic rate.

The taxpayer said to HMRC that his employers were responsible for the underpayment. HMRC disagreed and, in a letter dated 30 November 2012, told him to complete tax returns for the years in question. The deadline for the returns was 7 March 2013.

The taxpayer said he did not receive the letter or returns. In September 2013, HMRC sent him duplicate returns, saying they must be completed and the tax paid by 1 January 2014. The taxpayer continued to dispute the tax, although he filed the returns in April 2014 and finally paid the tax in October 2014.

HMRC imposed penalties for the late payment of tax, against which the taxpayer appealed. They also penalised the taxpayer for the late returns, but these were not the subject of this appeal.

Decision:

The First-tier Tribunal accepted that the taxpayer had not received the November 2012 letter and therefore had a reasonable excuse for not paying the tax by 7 March. However, the taxpayer should have managed to contact HMRC by 1 January 2014, so he did not have reasonable excuse for not paying the tax on that date.

On that basis, the tribunal decreed the penalty date as 31 January 2014 and reduced the penalties from £744 to £496. The taxpayer's appeal was allowed in part.

Comments – This case demonstrates how important it is that the correct procedures must be observed and complied with whatever the belief of the taxpayer. It is evident from the facts that the taxpayer took a long time to comply with the request for tax returns and therefore the Tribunal only allowed the reasonable excuse in part.

Dr F Kaivani V HMRC TC4620

More checks required by employer when using software

Summary – The FTT found that the employer's lack of reasonable care caused the failure to deduct under PAYE so that the tax could not be recovered from the relevant employee.

The taxpayer, a registered charity, employed Y during 2010/11. After a change in Y's PAYE code, the tax due for week 26 was greater than the salary she was due to receive. In those circumstances, the payroll system had been set up to deduct no tax from the employee's pay. However, it also generated an exception report stating "insufficient pay for tax". As a result, the taxpayer paid no tax for weeks 26 to 52.

HMRC sought to recover the tax from Y, but she said the underpayment was the responsibility of her employer. HMRC agreed and issued a determination under regulation 72 of the Income Tax (PAYE) Regulations 2003/2682.

The charity appealed.

Decision:

The First-tier Tribunal agreed with HMRC that the charity had not adequately investigated the exception report. The words in the report should have alerted the taxpayer to the fact that Y's income was not enough to cover the tax.

Having installed payroll software that identified anomalies, "a reasonable taxpayer exercising reasonable diligence" would have done more than check whether the PAYE code was being operated correctly. It would have investigated the consequence of using the code. The tribunal concluded that the charity had not taken reasonable care.

The taxpayer's appeal was dismissed.

Comments – The employer will end up paying twice – firstly to the employee and secondly to HMRC. It is a lesson to a charity to ensure they deal with matters more diligently to avoid the unnecessary extra costs. Although the Tribunal might have taken a more lenient attitude to the taxpayer being a charity, the principle remains the same irrespective of the taxpayer.

Chapter Trading Ltd (TC4626)

Not unreasonable behaviour by HMRC

Summary – The Tribunal found the behaviour by HMRC had not been unreasonable

The taxpayer applied for its costs following HMRC's decision to withdraw a penalty for a careless error in its VAT return, imposed under FA 2007, Sch 24, on the day before the taxpayer's appeal against the penalty was due to be heard by the First-tier Tribunal.

The taxpayer had appealed against the penalty on the grounds that the errors were genuine mistakes and led to no tax advantage.

The appeal was due for hearing on 18 November. On 17 November, the taxpayer sent HMRC a schedule indicating that output and input tax had been omitted from the return. It was therefore apparent to the Revenue that there was no lost revenue, which is necessary to determine the penalty, and that the fine would have to be withdrawn.

At the First-tier Tribunal, the taxpayer argued that HMRC had acted unreasonably because they held information that would have allowed them to withdraw the penalty earlier - the output tax had been incorrectly included in another return.

Decision:

The tribunal said, on this basis, it would have been equally possible for the taxpayer to have alerted HMRC to the correct position sooner, rather than wait to send a schedule on the afternoon before the appeal was to be heard. The taxpayer had not established that HMRC acted unreasonably. The tribunal dismissed the appeal.

Comments – The argument of unreasonable behaviour in cases involving the award of costs has a very chance of succeeding as is shown by the limited number of times the Tribunals and before them the Special Commissioners have awarded costs for such behaviour. Accordingly it is not too surprising that the decision by the Tribunal was that the behaviour by HMRC was not sufficiently unreasonable.

Executive Car Rentals Ltd v HMRC TC4640

Was the notice valid?

Summary – The Tribunal found that the taxpayer had not complied with the notice

The taxpayer provided accounting, tax and corporate services to contractors and consultants. The sole director of the company was PH.

HMRC investigated whether the arrangements between the taxpayer and its clients brought it within the scope of the managed service company legislation and issued a notice under FA 2008, Sch 36 requiring information and documents. For various reasons, including an accident suffered by PH's daughter and his adviser's poor health, the taxpayer provided only some of the information required. HMRC imposed penalties and the taxpayer appealed.

Decision:

The First-tier Tribunal found that the taxpayer had not complied with the notice. The judge said the daughter's accident did not provide a reasonable excuse. This was because the taxpayer had been given more than three months to collate the information and the accident took place only a day before the submission deadline. Further, the notice had been served on the taxpayer, rather than PH, so the resources of the company would have been available to comply with the notice.

Similarly, the adviser's illness did not furnish a reasonable excuse in part because his assistance was not needed to find the documents but also other members of his firm would have been available to assist.

Stating that the Sch 36 notice was reasonably requested, the tribunal then turned to whether it had been issued to check the taxpayer's position under para 1. HMRC said the notice was to obtain information about the taxpayer's business that would help them form a view on its tax position. The taxpayer claimed that HMRC were checking the tax position of its clients.

On this, the tribunal said a third party notice under Sch 36 para 2 would have been more appropriate. The possible liability of the taxpayer to account for tax under the managed service company legislation was “too remote”. Tax position, as defined in the tax legislation, did not mean tax liability. If HMRC wanted to find out whether the taxpayer was a managed service company provider in relation to its clients, the department could do so by enquiring into the clients' tax positions. The judge concluded that the information notice did not meet the requirements of Sch 36 para 1 because it did not relate to the taxpayer's tax position.

Finally, the tribunal found that the notice breached the taxpayer's clients' rights under article 8 of the European Convention on Human Rights. The notice referred to documents and information relating to clients of the taxpayer but this was “not a case where information provided by PML happens to contain information about its clients. Rather, its clients were the object of the enquiry”.

Were HMRC correct about the clients being managed service companies and the taxpayer being an managed service company provider in relation to them, the department would issue determinations on the clients. This invalidated the information notice.

Since the information notice was invalid, no penalties could arise for non-compliance.

The taxpayer's appeal was allowed.

Comments – This is an important case as it allows one to follow the logic of the Tribunal's thought process and how the rationale of a Sch 36 notice applies.

PML Accounting Ltd v HMRC TC4612

What was the basis of the Tribunal's conclusion?

Summary – The Tribunal could hear matters which were not specifically identified by HMRC

A partnership claimed loss relief as a result of a net realisable value adjustment for two properties.

The claim for the decline in value required two conditions to be met:

- the properties must have been trading stock as opposed to investment assets (the trading stock issue); and
- the partnership must have been trading in the year in which the claim was made (the commencement of trade issue).

HMRC refused the claim and issued a closure notice.

The notice was confined to the commencement of trade issue. The partnership said the First-tier Tribunal had jurisdiction to hear an appeal on this point only, but HMRC had put their case on the basis of the trading stock issue. The issue was whether the case should be struck out.

Decision:

The First-tier Tribunal said the High Court decision in *Tower MCashback LLP1 v CRC* [2008] STC 3366 and *Fidex Ltd v CRC* [2015] STC 702 had established that "a closure notice need not state reasons for its conclusion, and that any reasons that it does give for the conclusion will not limit the jurisdiction of the tribunal in an appeal against the closure notice". The conclusion would, though, limit the tribunal's jurisdiction since the subject matter of the appeal is defined by that of the enquiry.

The tribunal in this case had to decide whether the commencement of trade issue was the sole conclusion in the closure notice or whether it was a factor in a broader conclusion that the partnership was not entitled to make the net realisable value adjustment.

The judge decided that the conclusion in the closure notice was that the net realisable value adjustment was disallowed. Not only did the wording of the notice suggest this, but also the word "therefore", implying that HMRC were stating a conclusion.

As a result, the tribunal had jurisdiction to hear factual and legal arguments concerning the trading stock issue, regardless of whether it had been given as a reason for the conclusion in the closure notice.

There was no basis for striking out HMRC's case under rule 8(2)(a) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. HMRC should be allowed to amend their statement of case.

Comments – The High Court decision in *Tower MCashback LLP1 v CRC* [2008] STC 3366 and *Fidex Ltd v CRC* [2015] STC 702 had established that "a closure notice need not state reasons for its conclusion, and that any reasons that it does give for the conclusion will not limit the jurisdiction of the tribunal in an appeal against the closure notice". This case is useful demonstration of how the FTT will approach the case and therefore the limit of its jurisdiction.

B & K Lavery Property Trading Partnership v HMRC TC4637

Classification of cases

Summary - The FTT dismissed an application by the taxpayer for its appeal, against a disallowance of input tax, to be re-allocated as a complex case

JSM is an engineering contractor in the utilities sector. JSM appealed against HMRC's disallowance of £226,845 of input tax. The FTT allocated the case to the Standard category. JSM applied under the FTT Rules rule 23(3) for a direction that the case be re-allocated as Complex. JSM applied because it wished to bring the appeal within the costs regime of rule 10(1)(c), which only applies to complex cases. HMRC opposed the application.

The FTT may allocate a case as complex if it considers that:

1. the case will require lengthy or complex evidence or a lengthy hearing
2. the case involves a complex or important principle or issue or
3. the case involves a large sum

Decision:

<u>The case will require lengthy or complex evidence or a lengthy hearing</u>

Applying rule 23, the FTT first had to decide whether the evidence was complex and the hearing would be lengthy. The FTT found that inter alia five witness statements and four or five lever arch files were not out of the ordinary with a case concerning entitlement to deduct input tax. The hearing of the appeal was expected to last for six days, which is longer than most hearings. However, this was not so lengthy or unusual (especially given that the issue was whether supplies had been made) as to justify the re-allocation of the case as a complex case.

<u>The case involves a complex or important principle or issue</u>

The FTT had to decide whether the appeal 'raised a complex or important principle or issue'. Referring to *Capital Air Services* in the Upper Tribunal in 2010, the FTT noted that what is complex or important must be assessed in the context of taxation and tax appeals. The question of whether a taxpayer was entitled to deduct input tax was the type of issue considered by the tribunals on a regular basis. The case did not therefore raise a complex or important issue.

<u>The case involves a large sum</u>

The FTT had to consider whether the amount at stake, which was £226,845, was a large financial sum. The FTT noted that there are no published statistics giving the median value of appeals, so that any judgment would be one of 'experience and impression'. The FTT found that the amount was not a 'large financial sum'.

Comments – We get very few cases on the allocation of cases under the FFT rules. Any cases are therefore welcome. You should note the three factors for future reference. You will note that with most cases it can be difficult to allocate although cases that obviously meet the criteria will be easy to allocate. As will be appreciated the outcome with this type of case depends solely on the facts.

JSM Construction v HMRC TC 4641

Lucky to get suspended penalties

Summary – The FTT found that HMRC were correct to disallow expenditure incurred by the taxpayer in acquiring guaranteed equity bonds and the interest on the loan taken out to finance the bonds. The FTT also upheld the penalties levied by HMRC, finding the errors in the taxpayer's tax return were careless, however the FTT decided that it was appropriate to suspend the penalties subject to conditions

Mr Patel was a self-employed locum pharmacist. He also owned a company through which he had intended to import medicines. The import business never commenced, but at the time of the enquiry he intended that in the future he would undertake his locum pharmacist business through the company. HMRC enquired into both Mr Patel's and the company's tax affairs. Following the conclusion of the enquiries, in which amendments were made to Mr Patel's 2009–10 tax return and consequential assessments made in respect of prior years, there was a review, with most issues settled with the aid of the alternative dispute resolution (ADR) process. This appeal dealt with the three remaining issues relating to Mr Patel's tax return:

1. Whether Mr Patel was entitled to claim an interest deduction in respect of a loan taken out by him personally to finance the acquisition of guaranteed equity bonds

2. Whether Mr Patel was entitled to claim a deduction for the cost of the acquiring the bonds as part of his 'SIPP'.

3. Whether the penalties charged under the former s95 TMA 1970 and Sch 24 Finance Act 2007 ('FA 2007'), Sch. 24 for the errors in the submitted tax returns were correct.

Decision:

The FTT found against Mr Patel on the first two issues. Neither the interest, nor the cost of the bonds constituted expenses incurred wholly and exclusively for the purpose of his business.

The FTT added that the arrangement could not be described as a self-invested personal pension and that, even if it was, it would be an unapproved pension scheme with a specific tax regime.

The final and most important issue was whether HMRC had been right to impose a penalty for inaccuracy in a return. The FTT confirmed that penalties were chargeable. HMRC had agreed to conditionally suspend the penalties imposed on the company, but not those imposed on Mr Patel. HMRC's decision was therefore flawed in a 'judicial review' sense, since an HMRC officer acting reasonably would have realised that it was possible to impose conditions on Mr Patel personally. The FTT therefore suspended the penalties for 24 months.

Comments – This case is a very good reminder that taxpayers and their advisers should seek the suspension of penalties where it is possible and appropriate. It is very good news for professionals as the FTT specified that as part of the conditions for suspending the penalties the taxpayer had to appoint a 'professional accountant or tax advisor'.

Application for extension of time

Summary - The First-tier Tribunal (FTT) refused an application for an extension of time for requesting full written findings of fact and the reasons for their decision refusing reinstatement of a struck out appeal.

HMRC accepted the two appellants' late appeals against various charges to income tax, National Insurance contributions, interest and penalties. Following HMRC's delivery of their statements of case and list of documents in respect of both appeals, the FTT issued case management directions requiring the appellants' lists of documents and listing information. The FTT three times issued directions allowing the appellants extensions of time to supply the information, with the third direction stating that unless the appellants supplied the relevant information by the date given the appeals would be struck out. As nothing further was received by this date the FTT issued a direction striking out the appeals. The appellants requested that the appeals be reinstated, but on 9 July 2014 the FTT refused the application, including in its decision this statement of the appellants' appeal rights:

'This document contains a summary of the findings of fact and reasons for the decision. A party wishing to appeal against this decision must apply within 28 days of the date of release of this decision to the Tribunal for full written findings and reasons. When these have been prepared, the Tribunal will send them to the parties and may publish them on its website and either party will have 56 days in which to appeal. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.'

On 12 November 2014 an application was received by the FTT for permission to appeal late against the 9 July 2014 decision. The FTT acknowledged the application, but explained that before such as application can be considered the appellant had to apply for full findings of fact and reasons for the decision. On 22 May 2015 the FTT received letters from one of the appellants and their representative, which it took to be an application for an extension of time for requesting full findings of fact and reasons for the summary decision. The reason for the delay was attributed to the ill health and redundancy of one of the appellants, and the injury of the other appellant caused by a car accident.

Decision:

The FTT noted that it had the power to extend the 28 day time limit for applying for full findings of fact and reasons for the decision under the *FTT Rules* rule 5. The FTT found that a decision on whether or not to extend time for requesting full findings of fact and reasons was, in these circumstances, analogous to a decision on extending the time for bringing an appeal in the first place.

The FTT also considered it appropriate to take into account that this delay was not an isolated error by the appellants, but part of a pattern of the appellants' conduct throughout the appeals.

The FTT concluded that it was not appropriate to grant the extension and refused the appellants' application.

Hayat & Anor v HMRC TC468

Deadline Dates

1 November 2015

- The date by which payment of corporation tax liabilities need to be made for periods ended 31 January 2015 for small and medium-sized companies not liable to pay by instalments.

2 November 2015

- Form P46 (Car) for quarter ended 5 October 2015 - filing date.

5 November 2015

- The deadline for specified employment intermediaries to file return for the tax quarter ended 5 October 2015.

7 November 2015

- The due date for VAT returns to be filed and payment for 30 September 2015 quarter (electronic payment).

14 November 2015

- Payment date for quarterly corporation tax instalment for large companies depending on accounting year end.

- Filling date for Monthly EC sales list if paper return used.

19 November 2015

- Payment date for PAYE, NIC, CIS and student loan liabilities for month ended 5 November 2015 if not paying electronically.

- Filing date for monthly construction industry scheme return.

21 November 2015

- Filing date for online monthly EC sales list.
- Submission date for supplementary intrastat declarations for October 2015.

22 November 2015

- PAYE, NIC, CIS and student loan liabilities should have cleared into HMRC bank account.

25 November 2015

- Autumn statement by Chancellor of the Exchequer for 2015

30 November 2015

- Companies House should have received accounts of private companies with 28 February 2015 year end.
- Companies House should have received accounts of public limited companies with 31 May 2015 year end.
- HMRC should have received CTSA returns for companies with accounting periods ended 30 November 2014.

HMRC News

Reforms to the taxation non-domiciles (Lecture P924 – 9.20 minutes)

What is the government's objective?

David Gauke, financial secretary to the Treasury, summarised this in the foreword to the consultation. 'The government wants to attract talented individuals to live in the UK who will help to contribute to the success of this country by investing here and creating jobs. The longstanding tax rules for individuals who are not domiciled in the UK are an important feature of our internationally competitive tax system, and the government remains committed to that aim. However, it is only right that those people who choose to live in the UK for a very long time pay a fair share of tax, and those who are born in the UK with a UK domicile of origin cannot move abroad and return as a "non-dom".'

1. Introduction

The proposals are aimed primarily at two categories of non-UK domiciles (non-doms) :

- those who have been UK tax resident for at least 15 out of the last 20 years but remain non-UK domiciled under general law principles (these are described as long term residents); and
- those who have a UK domicile of origin and having left the UK and acquired a domicile of choice elsewhere, then return to the UK, even temporarily (these are described as 'returning UK doms').

The consultation will run until 11 November 2015, just six weeks from publication on 30 September 2015 (rather than the normal 12 week period). The new legislative provisions are likely to be introduced in Finance Bill 2016. Currently it is intended that the changes will take effect from 6 April 2017

A 'deemed domicile rule' will be introduced so that long term residents of the UK can no longer claim to be not domiciled for tax purposes. This abolishes the permanency of non-dom status. The new rules will also ensure that individuals who are born in the UK and who are UK domiciled at birth will not be able to claim that they are not domiciled for tax purposes while they are living in the UK. The government has also announced that it will legislate so that inheritance tax is charged on all UK residential property, including property held indirectly by non-doms through a structure like an offshore company or a trust.

Current rules for taxing non-doms

These are summarised and highlight that under these domicile rules, individuals who are resident but not domiciled in the UK:

- are able to claim tax relief on overseas workdays during the first three years they are in the UK
- are liable to UK tax on all income and capital gains which arise in the UK; but,
- can choose to pay UK tax on their foreign income and gains only if/when they remitted to the UK

Reference is also made to the remittance basis charge and how it operates

2. Deemed UK domicile for long term residents

From 6 April 2017, non-UK doms will be 'deemed domiciled' for all UK tax purposes once they have been resident for at least 15 of the past 20 tax years. Such individuals will cease to be able to use the remittance basis and, from the beginning of their 16th tax year of tax residence in the UK, will become subject to income tax, capital gains tax and IHT on their worldwide income, gains and assets.

Therefore the remittance basis can no longer be claimed indefinitely.

As the 15 out of 20 year rule will replace the existing IHT 17 out of 20 year rule this also means that individuals will be subject to IHT on their worldwide estates one year earlier The proposed rules will mean that an individual who has lived in the UK for 15 consecutive tax years and then leaves the UK for 6 or more consecutive tax years could return here and could claim non-dom status again for another 15 years (assuming they still had a foreign domicile status under general law).

A person who becomes deemed domiciled in the UK will potentially be subject to tax both on the arising basis (for new income and gains anywhere in the world) and the remittance basis (for foreign income and gains arising before they were deemed domiciled). The government recognises that the need to analyse historic income and gains may cause practical difficulties, and is considering how to address this.

Legislating the deemed test

The new rules will count any year of UK residence, including years spent while the individual is under the age of 18. However, that individual could still lose their deemed-UK domiciled status if they leave the UK and spend at least 6 years as a non-resident.

The deemed-domiciled status is not passed from a parent to their child.

As set out above, these changes will come into effect from April 2017. These reforms will mean that the £90,000 remittance basis charge will no longer be applicable.

Split years/statutory residence test

For the purpose of counting the 15 years of residence, the government intends to include any year in which the individual is resident even if they enter or leave the UK at some point during that year – i.e. tax years where split year treatment applies.

The new test will be introduced so that an individual becomes deemed-domiciled for the purposes of income tax, capital gains tax and inheritance tax at the same time. This will mean changing the way that the current deeming rules for inheritance tax work.

For tax years before the statutory residence test was introduced, individuals will have to assess their residence status based on the rules that were in place at the time, as they would do under the current rules for determining liability to the remittance basis charge and deemed-domicile status for IHT.

The government understands that stakeholders would like the deeming provision to align with the statutory residence test. However, aligning the two rules when the temporary non-residence rules look at periods of non-residence and the deemed-domicile status looks at tax years of residence is not straightforward. Given the complexities involved in trying to align these rules exactly, the government believes that a straightforward deeming test based on years of residence would be the most appropriate solution.

The intention of these reforms is that once a non-dom becomes deemed-UK domiciled they will be treated in the same way as a UK-domiciled individual, with the exception of certain protections that will be introduced for offshore trusts and arrangements caught by the Transfer of Assets legislation, provided they were set up before the individual became deemed-UK domiciled.

The current rules exempt from UK tax any individual who is not-domiciled in the UK and who has foreign income and gains of less than £2,000 annually on those amounts. This currently applies regardless of how long the individual has been resident in the UK. These rules need reconsidering in the light of the Budget announcement.

Offshore trusts

The government said at the outset of these reforms that it intended for there to be some protection for those individuals who had set up offshore trusts before they became deemed-domiciled. They think it is fair to ask any individual who becomes deemed-domiciled in the UK to pay tax on benefits they receive from any offshore trust and any underlying entities.

However, the government does not intend that non-doms who become deemed-UK domiciled should have to pay UK tax on income and gains in offshore structures which were set up before they became deemed-domiciled simply because the individual was the settlor of the trust or was considered a transferor under the Transfer of Assets Abroad legislation.

The government intends to base the new rules on the taxable value of benefits received by the deemed domiciled individual without reference to the income and gains arising in the offshore structure. This will be a very significant change to the way that the income and gains arising in offshore trusts and their underlying entities are taxed. There will be no need for trustees to have to recreate the history of the income and gains in the trust for tax purposes once an individual becomes deemed-UK domiciled.

Once a non-dom becomes deemed-UK domiciled, it will no longer be relevant whether a benefit is received in the UK or overseas; the value of that benefit will be treated as taxable regardless. However, UK source income will be taxable on the arising basis

Further consequences

There are further implications of being deemed UK domiciled that need to be considered in order to meet the policy objectives.

These include:

- the taxation of certain earnings and income from employment related securities
- Business travel for non-doms
- Tax compliance on foreign income and gains
- The capital losses election

Implications for IHT

Summer Budget 2015 confirmed that the IHT deemed domicile provisions would also be changed, so as to bring into line with proposed changes to income tax and CGT.

Under the new rules, the IHT deemed-domicile status will apply when individuals have been resident in the UK for at least 15 of the past 20 tax years immediately preceding the chargeable event. The effect of these reforms is that an individual will become deemed-domiciled for IHT at the start of their 16th consecutive year of UK residence, rather than at the start of their 17th year of residence under the current rules.

Offshore trusts that are set up by an individual who is not domiciled in the UK will remain outside the scope of UK IHT, even after that individual becomes deemed-UK domiciled. However, on becoming deemed-UK domiciled, an individual’s worldwide estate becomes liable to UK IHT.

One effect of the intended changes is that when an individual who has become deemed-UK domiciled ceases to be resident in the UK they will continue to be deemed-UK domiciled for up to 6 years following their departure. Once an individual is not resident in the UK, their deemed-UK domicile status will only be relevant for inheritance tax purposes. The deemed domicile status will not be relevant for income or capital gains tax purposes.

IHT for UK domiciles leaving the UK

Therefore an individual who is domiciled in the UK who leaves and acquires a domicile of choice in another country could potentially become not-domiciled for IHT more quickly than those individuals whose UK-domiciled status is only deemed. This would not be an outcome which is intuitively reasonable. To address concerns, the government is considering aligning the rules for UK domicilliaries.

The rules could be changed so that an individual is treated as domiciled until they have been non-resident for at least 6 years after they have acquired a domicile of choice elsewhere.

The government favours a rule which treats a UK domicile as non-domiciled on the later of the date that they acquire a domicile of choice in another country, or the point when they have not been resident in the UK for 6 years.

Potentially exempt transfers

The government intends that these reforms are introduced in such a way that if an individual who is not domiciled in the UK makes a potentially exempt transfer of an asset that is excluded property before they become deemed-domiciled, but within 7 years of their death, the transfer is not included in the death estate.

Spousal election

If the individual who is not domiciled in the UK so wishes, they are able to elect to be treated as being UK domiciled for IHT purposes. Electing into UK-domicile treatment for IHT purposes will mean that:

- transfers from a UK-domiciled spouse or civil partner will be exempt from IHT, but
- the electing individual's worldwide estate will henceforth be liable to UK IHT

Elections will be irrevocable while the electing individual continues to remain resident in the UK.

An election will cease to have effect if the electing person is resident outside the UK for more than four full consecutive tax years. In such cases the election will cease to have effect from the end of the fourth full tax year of non-residence. Therefore, an electing individual will not remain indefinitely liable to IHT on their overseas assets after a 4 year period which will be treated as effectively breaking their connection with the UK.

This consultation needs to consider the effect of these reforms on the spousal election.

3. Born in the UK with a UK domicile of origin

The second aspect of the reforms to restrict access to non-dom status are the proposals which will affect those individuals who were born in the UK with a UK domicile of origin but who have acquired a domicile of choice elsewhere.

The government does not believe that those individuals who were born in the UK with a UK domicile of origin should be able to benefit from the non-dom regime while they are resident in the UK. Legislation will be introduced so that from April 2017, an individual in this position will be treated as having a UK domicile of origin for tax purposes while they are resident in the UK.

If under the statutory residence test the year is split into a UK part and an overseas part, foreign income and gains arising in the overseas part will not be taxable in the UK. The individual will continue to be treated as not domiciled in the UK while they are not UK resident.

Such individuals will be treated as having a UK domicile for tax purposes. There will be no protection for offshore trusts, either in terms of the tax on income/gains in the trusts or for IHT purposes. The excluded property trust rules for IHT will be changed so that they do not apply in these circumstances.

Since the residence criteria will be based on the statutory residence test where individuals are either resident or non-resident for the whole year, it will create situations in which property will switch from being excluded property to being liable to IHT under the "relevant property" regime for periods of one or more tax years. If someone is frequently coming and going from the UK, the property in the trust will be excluded property one year and relevant property in the next year.

Born in the UK

The government thinks that it is only reasonable to treat those individuals who were born in the UK and who had a domicile of origin as being domiciled in the UK for tax purposes when they are resident here.

The government believes that it is reasonable to expect a returning UK-domiciliary to pay UK income tax and CGT on an arising basis while they are UK resident. The government does not intend these generous tax rules for non-doms to extend to those individuals who were born in the UK and whose domicile of origin was in the UK, even if they have subsequently moved abroad.

Impacts of the reforms

When the 10-year anniversary charge is payable on a relevant property trust, the charge will be apportioned if the settlor is not-domiciled but is treated as being UK domiciled by virtue of having been born in the UK with a UK domicile of origin and is resident in the UK. The apportionment will be based on the period of residence during the last 10 years. When the individual becomes non-resident again (and assuming they remain not domiciled in the UK), there is no exit charge.

The government is also aware that HMRC might need to publish updated guidance for banks on the withholding requirements for this group of individuals.

Leaving the UK

On departure from the UK, and assuming the individual retained their foreign domicile status under general law, the individual is treated as being not domiciled again once they become non-resident, unless they have been resident in the UK for 15 of the past 20 tax years (this assumes they have retained their foreign domicile status under general law). The individual who returns to the UK for a short period will be treated as UK-domiciled only for the period they are resident in the UK.

Remittance basis treatment of foreign income and gains used for collateral

Purpose of this brief

HM Revenue and Customs (HMRC) announcement on 4 August 2014 gave notice of the withdrawal of concessional remittance basis treatment of foreign income and gains used as collateral for certain loans brought into or used in the UK. This brief updates HMRC's position on arrangements for loans brought into or used in the UK before 4 August 2014.

Who needs to read this?

Anyone using the remittance basis who used foreign income and gains as collateral for a loan brought into or used in the UK before 4 August 2014.

Background

On 4 August 2014, HMRC withdrew its concessional practice published in 2010 in HMRC's guidance manual RDRM33170 as it was seeing large numbers of arrangements not considered to be within the intended scope of the concession.

HMRC's notice published on 4 August 2014 requested anyone using the remittance basis who used foreign income and gains as collateral for a loan brought into or used in the UK before that date to notify HMRC where they had not declared a remittance. The notice stated HMRC's intention to assess remittances for loan arrangements that used the concession if a written undertaking was not provided by 31 December 2015 that foreign income and gains collateral would be either repaid or replaced by non-foreign income and gains collateral before 5 April 2016, or the undertaking was not honoured.

This announcement

The purpose of the announcement on 4 August 2014 was to stop the concession being used in a way that was not intended, and to bring existing arrangements into line with HMRC's application of the remittance basis to loan collateral arrangements going forward from that date.

The transitional period to 5 April 2016 was intended to provide adequate opportunity to alter all arrangements where the loan was brought into or used in the UK before 4 August 2014, ensuring there was no penalty for relying on the concession when the arrangements were set up.

Discussions with representative bodies since the announcement have brought to light that for some loan arrangements it may be difficult or impossible to unwind or replace the foreign income or gains used as collateral.

To ensure the transitional period does not have an unintended effect, after careful consideration HMRC has decided it will, with effect from today, not seek to apply the change announced on 4 August 2014 to arrangements where the loan was brought into or used in the UK before that date. From today, there is no requirement to repay or replace foreign income and gains collateral with non-foreign income and gains collateral before 5 April 2016.

The effect of the withdrawal of the concession is maintained for arrangements where the loan is brought into or used in the UK on or after 4 August 2014. This ensures HMRC's change of practice operates as intended.

Tax enquiries: Closure rules consultation

On 18 December 2014, HM Revenue and Customs (HMRC) published a consultation document that asked for comments on a proposal to enable HMRC to refer matters to the Tribunal, with a view to achieving early resolution of one or more aspects of an enquiry into a tax return.

The consultation, "Tax Enquiries: Closure Rules", closed for comments on 12 March 2015. The consultation document covered several broad areas that HMRC considers creates problems and constraints within the enquiry framework. These areas are:

- Flexibility. The enquiry framework can be inflexible, leading to complex tax enquires taking a long time to settle.
- Complexity: complex cases where there is significant tax under consideration, or which involve issues which are novel or have wider impacts. As a consequence a long-running issue can prevent final resolution of a simpler issue; and
- Equity: in order to resolve an issue through litigation, HMRC will ideally select a 'representative case' based upon the quality of evidence that it contains, as this enables the Courts to make a more principled and reasoned decision. However, current enquiry rules often mean that a 'representative case' is selected because it is a stand-alone example of the point at issue. As a result, multi-aspect enquiries (and in particular multi-tax scheme users) reap a benefit in being less likely to be selected for litigation than a taxpayer with straightforward affairs.

There was overwhelming disagreement with the suggestion that HMRC should be able to use the proposed legislative change unilaterally.

There is general consensus that the current enquiry process should be improved in terms of being able to close settled aspects of enquiries. Whist the majority of respondents broadly agreed with HMRC's proposed approach, subject to certain caveats, equally a number of respondents felt that there are other, as equally practical, ways of achieving the same outcome.

There were two overwhelming views of respondents: firstly that any partial closure power should not rest exclusively with HMRC; and secondly that the safeguards regarding the use of any power should be more comprehensive and explicit.

HMRC proposes to proceed on the basis that there is a need to provide a partial closure provision. However, as the best, most practicable way to give that effect is not clear cut, HMRC proposes to develop a small number of alternative models. HMRC will then consult stakeholders in order to identify the optimum model.

HMRC's aim is to bring forward legislation in Finance Bill 2016. However, given the differing views of respondents on the optimum approach, and the time needed to consult further, it may be necessary to defer legislative change until Finance Bill 2017.

Crackdown on tax cheats nets £109m in just six months

HM Revenue and Customs (HMRC) taskforces have brought in £109 million in the last six months.

That figure includes £64.9 million recovered in the first three months of this year, more than double the figure for the same period in 2014.

Between April and October 2015, HMRC launched 27 new taskforces targeting sectors that are at the highest risk of tax fraud, including Income Tax Self Assessment (ITSA) Repayments, Retail, Hidden Wealth and Grocery sectors, with one taskforce alone generating 22 arrests.

Taskforces were first launched in spring 2011 as part of HMRC's compliance strategy to tackle tax evasion and fraud. Over 100 taskforces have been launched since then yielding more than £404 million, protecting this money for public services.

Speaking at the UK Tax Investigation Conference today, Jennie Granger, Director General for Enforcement and Compliance at HMRC, said:

> "The message is clear if you try to cheat on your tax we are going to catch you – it's only fair that we all pay what we should to fund public services. We have increasing amounts of intelligence, and are using state of the art digital tools to help us to identify and target high risk areas. This yield of £109 million – almost double the figure for the same period in 2014 - shows that our strategy is working."

Register to use the Payrolling Benefits in Kind online service

Introduction

PAYE legislation is changing. If you're intending to or already payroll benefits and expenses you must register them with HM Revenue and Customs (HMRC) using the new online Payrolling Benefits in Kind (PBIK) service. If you use this service and payroll benefits and expenses you won't have to report them on a P11D.

The only benefits you cannot payroll using this service are:

- vouchers and credit cards
- living accommodation
- interest free and low interest (beneficial) loans

If you're already payrolling these benefits you can continue to do so but you must still report them on a P11D.

You'll need to align your payroll software and register to payroll using the new service by 5 April 2016. You won't be able to register after this date for the 2016 to 2017 tax year as HMRC can't process changes in-year. To avoid being sent multiple tax codes for your employees you need to register before the annual coding process which usually starts around 21 December.

If you don't register the benefits and expenses you'll have to report them on a P11D. From the 2016 to 2017 tax year HMRC will no longer accept informal reports of employee benefits, sometimes referred to as lists.

All payrolled benefits and expenses need to be included when you report your payroll information in a Full Payment Submission.

P11D (b) forms must still be completed, including the total benefits and expenses provided, whether or not they've been put through your payroll. However, if you payroll car and car fuel benefit you mustn't complete P46 (Car) forms as you're deducting the tax due on these benefits at source.

Using the online service

You can:

- choose which benefits and expenses you want to include in the payroll for the following tax year
- add or remove benefits and expenses
- exclude employees who receive benefits or expenses but don't want them payrolled - for these employees you must continue to report the benefit or expense on a P11D

Section M on the P11D is used to report other items. For payrolling this needs to be treated with an all or nothing approach - you must either payroll all items that usually fall within Section M or none. Income Tax paid but not deducted from a director's remuneration needs to be selected and payrolled as a stand-alone benefit within the PBIK service.

When you register HMRC will automatically:

- identify which of your employees have the selected benefits or expenses in their tax code
- remove the selected benefit or expense and issue an amended tax code

You only need to register to payroll each benefit once – unless you remove the benefit your registration will be carried forward every year. Once the tax year has started you must continue to payroll the benefit or expense you've registered for the whole tax year or for as long as you provide it.

To use the service you'll need your Government Gateway ID.

How to payroll benefits and expenses

You collect the tax due on benefits and expenses by adding a notional value to your payroll, rather than reporting them separately on a P11D.

Before making the first main relevant payment to an employee in a tax year you need to calculate the cash equivalent of the benefit. You then need to determine the number of payments to be made to the specified employee in the tax year (weekly, fortnightly, monthly etc.) and divide the cash equivalent by the total number of payments to be made. The resulting amount is the taxable value of benefit which

should be added to the payroll each pay cycle as a notional value. Then deduct or repay tax as usual by reference to the employee's code, even if this is the subject of an objection or appeal.

Further technical guidance will follow after publication of the PAYE regulations.

End of Informal Payrolling process

If you have an agreement with HMRC, the existing informal payrolling process will stop on 5 April 2016.

Up to this date you must:

- complete the 'amount made good or from which tax deducted' fields where this applies
- complete a P11D(b) including the total benefits and expenses provided, even though they've been put through your payroll

How you submit P11Ds depends on which payments you've put through your payroll. If all the benefits and expenses paid to all your employees have gone through your payroll and you submit electronic P11Ds you need to agree with HMRC in advance that you'll be sending P11Ds for directors or employees using this online form.

If all the agreed benefits and expenses paid to some or all of your employees have gone through your payroll and you submit paper P11Ds you need to:

- submit P11D information where the benefits you've put through your payroll have a corresponding entry for 'amount made good or from which tax deducted'
- mark your paper submission (individual P11Ds or a list) 'PAYROLLED'

45% rate of corporation tax on restitution interest

The government is to introduce a 45% rate of corporation tax on restitution interest paid by HMRC arising from a mistake of law in specific circumstances with effect from 21 October 2015. This is intended to reflect the historic rates of corporation tax over the period to which typical awards relate, as well as the effect of compound interest. HMRC will also be obliged to withhold tax on payments of restitution interest from 26 October 2015. The changes are contained in a proposed new clause to be added to the Finance (No 2) Bill 2015 at report stage.

Business Taxation

Travel expenses incurred wholly and exclusively for private practice?

Summary – The Tribunal found that the travel expenses were not incurred wholly and exclusively

The taxpayer was a consultant anaesthetist in private practice. He travelled from his home, where he had an office, to hospitals, where he carried out his duties. In his tax returns, he claimed for the cost of travelling from his home to hospitals and in between hospitals.

HMRC allowed only the expense of travelling between hospitals and disallowed the rest.

The taxpayer appealed.

Decision:

The First-tier Tribunal said that, for the appeal to succeed, the travel expenses had to be incurred wholly and exclusively for the purpose of the taxpayer's private practice. The judge said there was “considerable case law authority” on the matter. He referred to a recent decision, *Samadian v CRC* [2014] STC 763, in which the judge ruled that travel between a person's home, even when the home was used as an office, and a place of business was not deductible except in “very exceptional circumstances”, such as a doctor having to make a special trip to his home to retrieve notes on a patient he was treating in hospital, that were not at the hospital. These did not exist in this case.

The tribunal accepted the taxpayer's home was a place of business, but he also carried out “significant professional functions” at the hospitals. Given the pattern of regular and predictable attendance at those hospitals, they were his places of business. As a result, in line with *Samadian*, the travel from his home/office to them was not deductible.

The taxpayer's appeal was dismissed.

Comments – This is the third case recently where the Tribunal have found that the travel expenses incurred by a self-employed taxpayer were not incurred wholly and exclusively in the course of their self-employment. The judge quoted the Dr Samadian case and that was closely followed by the White case involving a flying instructor. It would appear that we are likely to see more cases with this expanded principle of the places of business. In the October 2015 notes we covered the review of travel expenses but of course that related to employed individuals

Dr David Jones v HMRC TC4643

Income or profits – The crucial question?

Summary – The Tribunal found that the taxpayer was caught by the relevant legislation

The taxpayer was an electrical engineering consultant resident in the UK. In April 2001, he entered into an avoidance scheme marketed by a firm of Isle of Man tax consultants. Under the scheme, the taxpayer became the settlor of an Isle of Man trust in which he also had an interest in possession.

The trust became a partner in an Isle of Man partnership which entered into a contract with the taxpayer to provide his services. Under the contract, he was entitled to an annual fee of £15,000 and a share of the partnership profits as a trust beneficiary.

Under the UK/Isle of Man double tax treaty, the taxpayer would pay tax and National Insurance on the annual fee, but nothing on the partnership profits.

As a result of a case involving a similar scheme, *Padmore v CRC* [1987] STC 36, legislation (now ITTOIA 2005, s 858) was passed to counter such arrangements.

However, the aim of the scheme used by the taxpayer was that his trust income would be treated as a share of the partnership profits and, because he was not a partner, s 858 would not apply.

The legislation was subsequently amended retrospectively by adding s 858(4) which stated: "For the purposes of this section the members of a firm include any person entitled to a share of income of the fi rm." However, the taxpayer said s 858(4) did not apply because he was entitled to a share of the profits rather than the income.

The matter proceeded to the First-tier Tribunal.

Decision:

The judge said it may have been clearer had s 858(4) referred to profits rather than income. However, s 858 was an anti-avoidance provision designed to counter schemes involving a share of profits. Interpreting s 858(4) purposively and referring to other legislation, such as TMA 1970, s 12AB, it seemed to the tribunal that partnership income can be construed as meaning profits.

The judge concluded that the scheme in the appeal was caught by s 858 and the taxpayer should be treated as a member of the partnership because he was entitled to a share of its income. The taxpayer's appeal was dismissed.

Comments – The taxpayer tried to argue over the exact wording of the legislation and that the scheme was not caught. In the past many schemes have been created which rely on a loophole in the legislation because of the way that the legislation is structured and how the steps might be structured. We now see a more purposive approach and with that schemes being caught.

R Huitson v HMRC TC4621

Redemption of loan notes and S171A

Summary – The Court of Appeal determined that a joint election made under s171A TCGA 1992 was not valid.

The taxpayer had been issued loan notes as the consideration for the disposal of a subsidiary, so that the taxable gain had been 'held over'. Five years later, as part of a restructuring, the appellant and a company which had realised a capital loss were brought within the same group. The loan notes were then repaid and the appellant (treating the repayment of the loan notes as a disposal) entered into a joint election under s 171A with the loss making company.

Section 171A applies when a group company 'disposes of an asset to a person who is not a member of the group'. The point at issue was whether the satisfaction of a debt was the disposal of that debt by the creditor within the scope of s 171A.

Both the FTT and the UT had found against the taxpayer.

Decision:

The Court of Appeal stated that the legislation contemplates situations where there is a deemed disposal. Additionally, a disposal can take place without a corresponding acquisition. However, the court considered that 'the insistence in s 171A on a disposal (or "actual disposal") "to C" means that it only applies where the disposal of the asset in question results in a corresponding acquisition by C'.

The Court of Appeal rejected the argument that, on redemption of the loan notes, the appellant's rights were transferred to the issuer for a moment of time. The Court held that in 'the real world' when the debt was repaid, the obligation to pay was discharged, so that there were no remaining creditors' rights that could have been transferred to the issuer.

Comments – This case has now also gone against the taxpayer. It is ironic as it would have been simpler to transfer the loan notes within the group before the debt was repaid. There would have been no need to rely on s 171A.

DMWSHNZ v HMRC [2015] EWCA Civ 1036

Goodwill treatment following FA 2015 (Lecture B923 – 13.05 minutes)

Background

Under UK GAAP, companies are generally required to amortise the cost of goodwill acquired over its useful economic life. It has always been a fundamental tax principle, that accounting depreciation is not allowed as a deduction against profits. However, since 1 April 2002, companies have generally been able to deduct the amortisation charge for goodwill acquired after 31 March 2002. However, the Finance (No 2) Act 2015 has now abolished this tax relief for goodwill/customer-related intangibles purchased after 7 July 2015. This has major implications for companies structuring business acquisitions.

These rules have no impact on sole traders and partnerships etc – they have always treated all type of goodwill/most types of intangibles as 'chargeable assets for CGT purposes.

Broadly, there are now three main types of goodwill/intangible assets for corporate tax purposes:

- Goodwill purchased or internally created before 1 April 2002
- Goodwill/intangibles acquired/created between 1 April 2002 and 7 July 2015
- Goodwill/intangibles acquired/created after 7 July 2015

Sometimes there can be arguments about when internally generated goodwill was acquired. The legislation resolves this arbitrarily by stipulating that goodwill is created when the relevant trade starts (s884 CTA 2009).

Pre-1 April 2002 goodwill

Goodwill acquired or created by a company before 1 April 2002 remains firmly within the corporate 'capital gains' regime. Consequently, despite the accounting treatment, there is no tax amortisation relief for such goodwill. The tax is dealt with on a realisation basis when the company sells or transfers goodwill.

Capital gains on goodwill can be rolled-over but only against purchases of goodwill/intangibles.

Purchases between 1 April 2002 and 7 July 2015

Goodwill and other intangible assets acquired after 31 March 2002 came within the corporate intangibles regime (now dealt with in Part 9, CTA 2009). In such cases, tax relief is given on the goodwill amortisation charged in the company's accounts. As an alternative, companies could opt for a 4% straight-line goodwill deduction instead.

In April 2002, the intangible regime was seen as giving companies a valuable tax-break for business acquisitions. Therefore, when this benefit was taken away for goodwill/certain intangibles acquired after 7 July 2015, it is perhaps not surprising that this was viewed as an 'unfriendly' business measure.

Tax-deductible amortisation for goodwill acquired/created between 1 April 2002 and 7 July 2015 is retained. Thus, the new restrictions have no effect on companies that were already claiming goodwill tax relief before 7 July 2015.

Clamp down on goodwill acquired on incorporation

Goodwill acquired as a result of an incorporation transfer between 3 December 2014 and 7 July 2015 is effectively a sub-set of the 'second' type of goodwill.

As part of the clamp down on 'tax-efficient' business incorporations, the FA 2015 blocked amortisation tax relief for 'new' goodwill sold to a 'connected' company after 2 December 2014 (s849B to s849D, CTA 2009). However, these provisions were abolished on 8 July 2015. Following the wider abolition of tax relief for goodwill on all post-7 July 2015 transactions they simply were no longer required.

Goodwill/customer-related intangibles acquired/created after 7 July 2015

The Finance (No2) Act 2015 prevents goodwill amortisation tax relief being claimed on goodwill and customer-related intangibles acquired after 7 July 2015.

The (new) s816A, CTA 2009 makes it clear that 'no debits' are tax-deductible for these 'relevant assets', which are defined as:

- Goodwill
- Information relating to customers or potential customers
- Contractual or non-contractual relationships with customers
- Unregistered trade marks or other signs used in the business
- A licence or right relating to any of the above assets

This means that the goodwill/intangible amortisation (or impairment) for these assets would be added-back as an adjustment to profit in a company's tax computations. Any taxable profit or tax loss would crystalise when a 'relevant asset' was subsequently sold. The 'credit' (profit) would invariably be treated as a trading receipt under s747, CTA 2009.

On the other hand, any losses on disposal are treated as a non-trading debit (s816A (4), CTA 2009). Companies can deduct non-trading debits against their other profits of the same accounting period (s753(1), CTA 2009) or group relieve them (s99(1), CTA 2010). However, any 'excess' non-trading debit cannot be carried forward to shelter future trading profits, thus restricting access to future tax relief.

Intangible fixed assets that do not fall within the above 'relevant asset' definition are not subject to any restrictions. Intangibles amortisation relief is therefore still available for intellectual property assets such as patents, know-how, registered designs, copyright or design rights, brands, and so on.

Contributed by Peter Rayney

VAT

Was the supply more than land?

Summary – The Tribunal has held the relevant supply was of services rather than land

The company organised antiques and collectors' fairs. Visitors' admission fees were subject to VAT at the standard rate. Exhibitors' pitch fees were treated as exempt on the basis that they were exempt supplies of land.

In 2012, HMRC decided that the stallholders were receiving the benefit of a fully organised fair provided by the company. This included security, advertising, electricity, and supervision at the venue. The land benefit was incidental and would be of no value without the company organising the antiques fair. HMRC also referred to the company's accounts, which described its activity as "organising conferences and exhibitions and antiques fairs" rather than "the letting of land".

According to HMRC, the supply was a standard-rated supply of services.

The taxpayer appealed. It claimed that each contract with an exhibitor for a pitch constituted an exempt letting of immovable property (VATA 1994, Sch 9 group 1).

Decision:

The First-tier Tribunal said "the economic and social reality" was that the fees paid by exhibitors were consideration to participate in antiques fairs. The booking pack described what exhibitors received as the chance to sell to buyers at a successful fair organised by the company. The "over-arching single supply by the company" should be treated as participation as a seller in an "expertly organised and expertly run antiques and collectors' fair". The provision of a pitch was only one element of the supply. The booking fee was a standard-rated supply.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, has noted that: "This decision creates uncertainty for businesses involved in the organisation of events and seems to contradict another recent decision, *Kati Zombory-Moldovan v HMRC* (TC4428). This was included in the notes for October 2015.

Many companies might be tempted to opt to tax the sites where events are held so that supplies are standard rated in all cases, but this is not helpful to many exhibitors who are not VAT-registered and unable to claim input tax. The decision also seems to go against HMRC's own advice in public notice 742 at paragraph 2.6 about the exemption for 'granting traders a pitch in a market or at a car boot sale', although they would argue that the company was supplying much more than a pitch to exhibitors and therefore this paragraph is not relevant."

International Antiques and Collectors' Fairs Ltd v HMRC TC4538

Backdating request for de-registration refused until received

Summary – The Tribunal has determined that the request to back-date the de-registration could not be dealt with until the request had been made to HMRC

The taxpayer ran a VAT-registered hairdressing and beauty business. In spring 2013, she sold the beauty salon and was advised by her accountant to monitor her turnover so that she could deregister as soon as possible.

A year later she contacted her adviser to say her turnover had fallen below the VAT threshold. He said he would send her a deregistration form but failed to do so until five weeks later. Finally, on 3 June 2014, HMRC received the application to deregister the business.

The taxpayer asked the Revenue to backdate the de-registration to 8 April 2014, when she first established that she was trading below the relevant threshold.

HMRC refused on the basis that, although they accepted she was not liable to be registered from 8 April, under VATA 1994, Sch 1 they were unable to deregister her business until they received the request to do so. The taxpayer appealed.

Decision:

The First-tier Tribunal said that under Sch 1, para 13(1), deregistration could not take place until the taxpayer had made the request to HMRC. This happened on 3 June. Further, para 13(2) was of no assistance to her because although for the purposes of para 13(2) she ceased "to be registrable – subpara (5) prevents deregistration under subpara (2) because for the purposes of subpara (5) she was to be treated as registrable!"

This was an "unfortunate result" and the taxpayer had acted reasonably, but the legislation left no room for leniency on the ground of a third party's delay.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, stated: "This case highlights the importance of clients and accountants dealing with paperwork promptly when it comes to deregistration. There was a five week delay between the client speaking to her accountant and the latter sending her the relevant form. She took a week to complete and return it to him. There was then a further delay in it being posted to HMRC. The best way to deregister is online – the days of using a paper VAT7 form are largely consigned to history."

Hayley Mundy trading as Hayley's Hair Design v HMRC TC4505

Risk of fraud should have been known

Summary – The Tribunal determined that the taxpayer transacting in the mobile phones should have been aware that the transactions might be part of an MTIC fraud

In April 2006, the taxpayer bought four lots of mobile phones from T for £5,941,750 plus VAT. The taxpayer knew the phones had been imported into the UK from France. On the same day that it purchased the phones, it sold them for £6,176,500 to W, a Spain-based customer of T, to be delivered in France, where T also had a French operation. The sales were zero rated, so the taxpayer did not charge output VAT. It claimed input tax on the four purchases.

HMRC refused the claim, saying the transactions formed part of a missing trader intra-community fraud and the taxpayer knew or should have been aware of it.

The First-tier Tribunal dismissed the taxpayer's appeal on the ground it should have known that the transactions were connected to fraud, although it accepted that the taxpayer had no "actual knowledge" of this.

The taxpayer appealed, saying the First-tier Tribunal had misinterpreted the "should have known" test.

Decision:

The Upper Tribunal agreed with the First-tier Tribunal that the taxpayer could not elude the test by deliberately not asking the questions that would have led it to conclude that the transactions were fraudulent. The taxpayer's knowledge of the phone market and the presence of fraud in it should have prompted it to make enquiries.

The taxpayer's appeal was dismissed.

Comments – This represents a fairly clear cut decision and the logic of the case is self-explanatory.

Wireless Wizards Ltd v CRC, Upper Tribunal

Buying and selling a business (Lecture B924 – 13.47 minutes)

Introduction

Why do the VAT rules concerning 'transfers of a going concern' (TOGC) often cause big problems for advisers? The reason is because this is often a 'grey' area in the world of tax as to whether business assets are being sold (subject to 20% VAT in most cases) or whether the deal relates to the sale of a business, in which case the proceeds are usually outside the scope of VAT because the legislation deems that neither a supply of goods or services has taken place (Article 5(1) of the Value Added Tax (Special Provisions) Order 1995, Reg 1995/2518).

Is a business being sold?

In most cases, it will be very clear if a business is being sold. For example, an accountant I act for has recently retired and sold his practice to another firm of accountants, and the deal included the transfer of all clients, staff, premises, computers, furniture, fixtures and fittings. As long as the conditions for a TOGC were met (see below), then the proceeds of the sale will exclude VAT.

A myth that needs to be dispelled is that the proceeds of a sale must always include a payment for 'goodwill' if it is to be classed as a TOGC. This is incorrect – think of a loss making business being sold, or one that has perhaps experienced a decline in trading performance where there is still a business in place but a goodwill payment is not appropriate.

Another important point is that a TOGC can also relate to a part-business sale:

Example 1

The owners of Bartram Hotel have decided to sell the restaurant part of their business to a third party caterer (Antonio) for £100,000. Antonio will then pay rent to the owners for the right to trade at the hotel premises. The other income sources of the hotel will continue unchanged ie in relation to overnight accommodation, bar sales and conferences.

In this situation, there is a part sale of the hotel business and the £100,000 proceeds can still qualify as a TOGC for VAT purposes as long as the relevant conditions are met.

Conditions of a TOGC

Article 5(1) clearly explains the conditions for a TOGC to apply, which can be summarised as follows:

- The same type of business must be carried on by the buyer as the seller when he takes over the business
- If the seller was VAT registered, the buyer must also be registered or liable to be registered at the time of the deal
- There should be no significant break in trading when the new owner takes over the business
- There must not be consecutive transfers of the same business
- In cases where part of a business is being sold, it must be capable of separate operation from the main business ie as in the case of Bartram Hotel at **Example 1.**

The specific details of the above rules have been helped by many tribunal decisions over the years. For example, in the case of an Indian restaurant being sold to new owners who intend to convert it into a Chinese restaurant, this is absolutely fine because the sale of a restaurant business is taking place - the fact that the new owners intend to change the menu is irrelevant.

The issue of VAT registration became a big challenge a few years ago, mainly because of delays with HMRC issuing VAT numbers because of their stringent and often time-consuming checks to reduce carousel fraud. There were many deals where we had to take advantage of the words 'liable to be registered' in the legislation because no VAT registration number had been issued by HMRC to the buyer before the sale. What does this mean exactly? The answer is that when a buyer determines his effective date of VAT registration, he must take into consideration the taxable sales of the seller. So if the seller had taxable sales of more than £82,000 in the 12-month period leading up to the sale, the buyer is 'liable to be registered' from his first day of ownership.

Example 2

Antonio from Example 1 applied to HMRC for his VAT registration number on 1 May 2015. The business sale took place on 31 May 2015 but Antonio's VAT number had still not arrived. However, the annual sales of the restaurant for the sellers was £200,000 (excluding VAT), so Antonio was liable to be VAT registered when he took over the business on 31 May because the annual sales of the business exceed the registration threshold. So even though he could not produce a VAT number to the seller's solicitors on 31 May, the TOGC condition about VAT registration had still been met.

Input tax issues for the buyer

A condition of claiming input tax is that it can only be claimed by a business if VAT was correctly charged in the first place. So what would happen if the owners of Bartram Hotel incorrectly charged Antonio £20,000 VAT on the sale of the restaurant and he has claimed input tax on his own return but an HMRC officer is now seeking to disallow his claim? The officer has told Antonio that the fact that he paid the VAT to the hotel and also received a tax invoice is irrelevant – he should not have claimed input tax. The officer has advised Antonio to contact the hotel and acquire a VAT credit, and the officer will assess Antonio for £20,000 plus interest in relation to his input tax error.

The officer's action is correct and hopefully Antonio will be able to acquire a VAT credit from the hotel owners and the latter can adjust their output tax so that neither party is out of pocket (apart from interest payable by Antonio on the officer's assessment).

But what would happen if a seller ceased to trade when he sold his business and disappeared to Spain to enjoy a sun filled retirement with no worry about business issues? In other words, the buyer has no chance of getting a VAT credit from the seller to recover any incorrectly charged VAT. The good news is that there is a window of opportunity if HMRC are satisfied that the seller has declared the output tax on his own VAT return and fully paid the tax to HMRC. See below. However, it is important to remember that the HMRC policy is a special concession based on common sense to help buyers who have been caught out by an incorrect VAT charge, so it is important to co-operate with the officer to achieve a good outcome.

Incorrect input tax claim by buyer where TOGC treatment applies – HMRC policy (VTOGC4200)

However, where you are wholly satisfied that the amount of "VAT" on the invoice has been both declared **and paid to HMRC** by the seller, you may allow the purchaser to recover it as if it were input tax. This is allowed under care and management of the Revenue, to avoid unnecessary bureaucracy where no tax is at risk. Businesses should be told in writing that, although the Department maintains that the "tax" is not actually input tax, in the circumstances no action will be taken to recover it from them. Where returns have not been rendered by the seller or it is not clear that the "tax" has been paid, this treatment is not appropriate.

Recent tribunal case – HMRC win

In the recent case of Amor Interiors Ltd (TC4542), the company purchased a lot of fixed assets and stock from an associated company Old Miller Furniture Ltd (OMF) between March and May 2011. The items were charged to Amor on 16 different sales invoices (plus VAT) and Amor claimed input tax on its VAT returns. However, OMF did not account for output tax on the sales because the company went into liquidation in October 2011 and did not pay HMRC the VAT for the March to May period from earlier in the year ie including the output tax on the invoices to Amor.

However, HMRC decided that Amor's input tax should be disallowed on the basis that a TOGC situation was evident. Their argument was supported by the fact that the two companies had the same trading activity (Amor sold to retail customers and OMF dealt with trade customers) and Amor also took over the contracts of five employees for OMR in May 2011 ie a further indicator of a TOGC arrangement. To quote from paragraph 29:

"The narratives on the invoices listed in paragraph 4 above demonstrate that Amor Interiors Limited received all of the assets required to carry on the same kind of business as Old Mill Furniture Limited and Mr Barrs confirmed that they do carry on the same kind of business. The transfer of five members of staff, leaving only the directors at Old Mill Furniture Limited, also weighed in favour of the transfers being a TOGC."

Final comment

The issue of whether a TOGC is evident depends on a clear analysis of all relevant arrangements to determine the VAT position (substance over form). The rules are not optional so neither the buyer nor the seller should 'play safe' and allow an incorrect VAT charge and hope that the buyer can claim input tax (a dangerous policy as explained above).

Contributed by Neil Warren

VAT on staff benefits (Lecture B920 – 10.30 minutes)

Introduction

Imagine the following situation: you are a retailer in business selling clothes and you very generously give all of your staff a quarterly allowance of free clothing. They will wear some of the items while on duty and some will be used for domestic purposes only. What is the VAT position in relation to these free supplies of stock? We'll consider the answer to this question in this session.

Business gift rules

What is a business gift and what is the VAT treatment of the gift? Quite logically, a gift of goods or services takes place where no payment is received from the recipient. It should always be remembered that payment can be in a non-monetary form as well as cash. I always enjoy telling the story about the window cleaner I visited as a C&E officer nearly 30 years ago, who was cleaning windows in return for free golf club membership, free meals at restaurants and even the free use of a car from a local hire company. There was no gift situation here and there was an output tax liability on the value of the benefits he had received from all of these customers.

The good news is that a business providing free services does not usually have an output tax liability but the rules are very different for goods. In such cases, no output tax is due if the value of the gift (including the total of all other gifts to the same person in any 12-month period) is less than £50 and the gift was given for business purposes eg to reward a loyal customer or member of staff. The £50 limit is VAT exclusive and is based on the cost of the item to the business when it bought it, rather than eg the shop floor retail price. The bad news is that if the £50 limit is exceeded, then the earlier gifts also become subject to output tax.

Output tax on gifts

Bill is VAT registered as a wine merchant and completes his returns on a calendar quarter basis. He has a very good customer called Mike, and he gives him the following free gifts from his stock (all figures are at cost price excluding VAT):

January 2015 - a vintage bottle of champagne worth £30

July 2015 – a bottle of red wine worth £10

Christmas 2015 – a bottle of white wine worth £15

The total value of gifts to Mike in the 12 month period to Christmas 2015 exceeded £50, so Bill should account for output tax of £11 on his December VAT return ie £55 x 20%. (HMRC Notice 700/7 para 2.3).

What is a uniform?

The issue in the case of French Connection Ltd (TC43467) was whether free clothing given to employees represented a supply for VAT purposes and therefore a liability for output tax purposes.

Each employee receives a quarterly clothing allowance – and this is free of charge unless the employee leaves the company's employment within three months of receiving the items, in which case they are charged an amount equal to 30% of their annual allowance through their salary and output tax is paid on these deductions.

The taxpayer agreed that the supply was subject to output tax if the annual value of the gift exceeded £50 but claimed that the items relevant to store personnel were for a business purpose (as a uniform) so no output tax was payable. However, the tribunal disagreed and felt that there was no difference between a non-business or business purpose for the supply. If input tax had been recovered on the initial purchase of the goods, then an output tax liability existed when they were given to the employee, adjusting for the £50 gift allowance. To quote from the report:

"The wide variety of clothing which staff members may select, particularly to assist in promotion of the French Connection brand, means that in formal terms the description of such clothing as a "uniform" is not appropriate.

The adjective "uniform" as defined in the Concise Oxford English Dictionary is: "the same in all cases and at all times; not varying". We do not consider that the clothing is "uniform" in that sense."

The taxpayer's final argument was that the key date for output tax purposes was three months after the date of the supply, at which point the employee would not be required to make any payment for the goods received if they were still in the company's employment. The tribunal rejected this approach and confirmed that the relevant date was when the items were first supplied to the employee. HMRC's assessment was therefore correct.

So the conclusion from this case is that it is very difficult for an item of clothing to qualify as a 'uniform' if it can be used personally by employees when they finish work.

Food and drink for staff

Example - a business has traded very successfully, so has decided to celebrate its success by hiring a box for a top soccer match in the country's footballing capital of Manchester. The day's festivities, including free food and drink, will be enjoyed by ten staff and ten customers ie 50% of the guests will be staff. What is the input tax treatment on the costs?

The bad news is that there is an input tax block on the costs relevant to the customers under the business entertaining rules (HMRC Notice 700/65, para 2.1) but the position for the employees depends on their role at the game.

In other words, if their role is to act as hosts for the customers, to ensure they have a good day and place lots of orders with the company, then the input tax is also blocked on their costs. But if they are able to enjoy the day without any hosting function, then a claim on 50% of the costs is fine (HMRC Notice 700/65, para 3.3). This is because free supplies of food and drink to staff is considered to be a legitimate business expense as long as there is no hosting of non-staff involved.

Contributed by Neil Warren