Tolley®CPD

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Contents

Personal Tax

Round up of changes to car and van benefits (Lecture P931 – 15.10 minutes)

Low emission vehicles

The table below provides a useful summary of the tax position for low emission vehicles going forward:

	0 – 50g/km	**51 – 75g/km**	**76 – 94g/km**
Currently	5%	9%	13%
April 2016	7%	11%	15%
April 2017	9%	13%	17%
April 2018	13%	16%	19%
April 2019	16%	19%	22%

There is a 1% increase for every 5g/km over 94g/km up to a maximum benefit of 37% in 2015/16.

The 3% supplement for diesel cars was due to be abolished from April 2016 but this will now remain until 2021.

Cars with the maximum charge

The table below shows how the maximum charge will be applied up until 2019:

Emissions:	**37%**
Currently	210g/km
April 2016	200g/km
April 2017	190g/km
April 2018	180g/km
April 2019	165g/km

Company cars are facing ever increasing charges so clients need to understand the tax implications of their car choice. For example, in 2014/15 a car with emissions of 165g/km would have been had a 26% benefit; this will have increased to the maximum 37% in 2019/20.

As ever cars with a low list price and low emissions still represent good value and are often an attractive perk car.

Illustration 1

Dean trades through a company and plans to lease a VW Up 1.0 High for his son Max (17 years old) through his company. The list price of the car is £12,000 and the car has $C0_2$ emissions of 105g/km. Dean will pay a deposit of £995 plus monthly lease costs of £95 + VAT.

Max does not work for the company so the benefit in kind will be taxable on Dean as part of his remuneration package.

Income tax on Dean:

2015/16: £12,000 @ 16% = £1,920 @ 40% = £768

2016/17: £12,000 @ 18% = £2,160 @ 40% = £864

2017/18: £12,000 @ 20% = £2,400 @ 40% = £960

Company's position per car:

50% of VAT on lease rental recovered

CT relief on lease cost plus 50% of irrecoverable VAT (approx £250 pa)

Class 1A NIC on £1,920 @ 13.8% = £265 pa

Corporation tax relief on repairs, road tax, insurance and on Class 1A

Is it worth buying this car through his company? With the personal taxable benefits being compensated by the tax reliefs that would be available to the company, the cost to Dean of providing his son with a safe, reliable car with low running costs are low. This may well be an option that is worth considering.

Illustration 2

Let's now consider Dean's own diesel car which he drives 20,000 miles per annum. His company leases his BMW 520d SE Step Auto that has a list price of £35,000 and $C0_2$ emissions of 119g/km. The monthly lease cost is £409 + VAT which includes a maintenance element of £52 + VAT.

Income tax on Dean:

2015/16: £35,000 @ 21% = £7,350 @ 40% = £2,940

2016/17: £35,000 @ 23% = £8,050 @ 40% = £3,220

Company's position per car:

50% of VAT on lease rental recovered and 100% of maintenance element

CT relief on lease cost plus 50% of irrecoverable VAT (approximately £1,067 pa)

Class 1A NIC on £7,350 @ 13.8% = £1,014 pa

Corporation tax relief on insurance and on £1,014 above

For many people in Dean's position, leasing German cars that have high residuals and low emissions are a good option; contrast this with an equivalent £35,000 vehicle with a 37% taxable benefit which would be a lot more expensive.

Van benefit

The current van benefit is £3,150 and zero emission vans have a benefit in kind currently calculated at 20%. However, this percentage is increasing to:

40% for 2016/17

60% for 2017/18

80% for 2018/19

90% for 2019/20

100% for 2020/21

HMRC publish a list of vehicles that HMRC class as vans for VAT input tax recovery purposes which can be found at:

https://www.gov.uk/government/publications/hm-revenue-and-customs-car-derived-vans-and-combi-vans

This list can be used as a starting point when considering the tax treatment of vehicles in other areas such as car v van for benefit purposes and AIA or WDA when considering capital allowances.

Changes to dividend taxation – FB 2016 clauses (Lecture P932 – 8.21 minutes)

As announced in the 2015 Summer Budget a new Dividend Allowance is to be introduced for UK resident individuals for 2016/17 onwards. The current system of taxing dividends, complete with dividend tax credits, is abolished. The Dividend Allowance will be £5,000, and dividends in excess of the allowance will be taxed at the following rates:

- 7.5% (dividend ordinary rate) on dividends within the basic rate band;
- 32.5% (dividend upper rate) on dividends within the higher rate band;
- 38.1% (dividend additional rate) on dividends above the higher rate limit.

The basic rate limit is £32,000 for 2016/17, and the higher rate limit remains at £150,000. As is already the case dividend income will generally be treated as the highest part of an individual's income for the sake of determining into which rate band it falls. There is no distinction between dividends from UK companies and those from overseas companies; all dividends (and other company distributions etc. counted as dividends) will potentially attract the Dividend Allowance. Dividends within an ISA will continue to be tax-free, and do not count towards the Allowance.

The Dividend Allowance is not a deduction in arriving at total income or taxable income. Instead, the first £5,000 of dividend income will attract a zero rate of income tax (the 'dividend nil rate'). This reflects what was set out in HMRC's Dividend Allowance factsheet of 17 August 2015 at :

www.gov.uk/government/publications/dividend-allowance-factsheet,

This is best illustrated by an example.

2016/17	£
Pension income	36,000
Dividends	8,000
Total income	44,000
Deduct: Personal allowance	11,000
Taxable income	£33,000

Taxable as follows:

25,000	@ 20%	(non-dividend income net of Personal Allowance)	5,000.00
5,000	@ 0%	(dividends covered by Dividend Allowance)	0.00
2,000	@ 7.5%	(dividends taxable at the dividend ordinary rate)	150.00
32,000	Basic rate limit		
1,000	@ 32.5%	(dividends taxable at the dividend upper rate)	325.00
33,000			
Tax payable			£5,475.00

The methodology is similar where dividend income straddles the higher rate limit, with dividends above the limit (and in excess of the £5,000 allowance) being taxed at 38.1%.

By way of comparison, if no changes were being made to dividend taxation the above computation would have looked like this.

			£
Pension income			36,000
Dividends + dividend tax credits at one-ninth of net dividends			8,888
Total income			44,888
Deduct: Personal allowance			11,000
Taxable income			£33,888

Taxable as follows:

25,000	@ 20%	(non-dividend income net of Personal Allowance)	5,000.00
7,000	@ 10%	(dividends taxable at the dividend ordinary rate)	700.00
32,000	Basic rate limit		
1,888	@ 32.5%	(dividends taxable at the dividend upper rate)	613.60
33,888			
			6,313.60
Deduct: Dividend tax credits (£8,888 @ 10%)			888.80
Tax payable			£5,424.80

For 2015/16, the dividend ordinary, upper and additional rates are, respectively, 10%, 32.5% and 37.5%. However, a comparison between these and the 2016/17 rates is misleading due to the effect of dividend tax credits in 2015/16. Taking the tax credits into account, the effective rates for 2015/16 are, respectively, 0%, 25% and 30.55%.

Abolition of dividend tax credits etc.

Dividend tax credits are abolished for all purposes for 2016/17 onwards. There are currently some tax rules under which a person is treated as having paid tax at the dividend ordinary rate on an amount that is chargeable to tax as if it were a distribution made to him. This applies to stock dividends, other non-qualifying distributions and income treated as arising on the release of a loan made by a close company to one of its participators. These rules are also abolished.

The rule in ITTOIA 2005, s 399, whereby a non-UK resident is treated as having paid (non-repayable) tax at the dividend ordinary rate on the amount or value of the dividend, is, however, retained, but without the current grossing up of the dividend by reference to the dividend ordinary rate. It is also made clear that ITTOIA 2005, s 399 does only apply to dividends received by non-UK residents, a position thrown into doubt by the First-tier Tribunal in Shirley v HMRC, [2014] UKFTT 1023 (TC), [2015] SFTD 247.

A large number of consequential amendments to current income tax and corporation tax legislation are to be made as a result of the abolition of dividend tax credits.

Trusts and personal representatives

The draft legislation and related documents are largely silent on the subject of dividends received by trusts and personal representatives in 2016/17 onwards. What seems clear though is that:

- the Dividend Allowance is available only to UK resident individuals and not to anyone else, for example trustees and personal representatives;
- the abolition of dividend tax credits applies across the board regardless of the status of the recipient; and
- dividend income received by beneficiaries of deceased estates will continue to be grossed up at (and will have borne tax in the estate at) the dividend ordinary rate, which will now, however, be 7.5% as above.

It has been confirmed in correspondence with HMRC that the dividend trust rate will continue to apply to dividends received by trusts with accumulated or discretionary income, and that this rate will be increased to 38.1% from 6 April 2016 so as to continue to mirror the additional rate of tax for individuals.

Article prepared by Tolley Guidance

Personal savings allowance – FB 2016 clauses (Lecture P933 – 7.30 minutes)

As announced in the 2015 Spring Budget, a new Personal Savings Allowance (PSA) is to be introduced for individuals for 2016/17 onwards. This will operate in conjunction with the current 0% starting rate for savings and the £5,000 starting rate limit, both of which will continue unchanged. Also for 2016/17 onwards, banks, building societies and National Savings will no longer be required to deduct basic rate income tax at source from interest they pay to their customers. Savings income within an ISA will continue to be tax-free, and does not need to be covered by the PSA.

The PSA will be £1,000 for basic rate taxpayers, i.e. those who have no income chargeable at the higher or additional rates or the dividend upper and additional rates. For taxpayers with income chargeable at the higher but not the additional rate (or at the dividend upper but not the dividend additional rate), the PSA will be £500. Taxpayers with income chargeable at the additional rate or dividend additional rate will not be entitled to a PSA.

Note that if dividend income is, in fact, chargeable at a zero rate of income tax because of the Dividend Allowance but would otherwise have been chargeable at the dividend upper or additional rate, it is treated as if it had been chargeable at that upper or additional rate for the purpose of determining the amount (if any) of the PSA. Taxable savings income must itself be taken into account for that purpose.

The PSA is not a deduction in arriving at total income or taxable income. Instead, the savings income covered by the PSA (whether the available PSA be £500 or £1,000) will attract a zero rate of income tax.

Example

2016/17	£
Pension income	36,000
Dividends	8,000
Bank deposit interest received gross	2,500
Total income	46,500
Deduct: Personal allowance	11,000
Taxable income	£35,500

Taxable as follows:

25,000	@ 20%	(non-dividend/non-savings income net of PA)	5,000.00
500	@ 0%	(savings income covered by PSA)	0.00
2,000	@ 20%	(savings income taxable at basic rate)	400.00
4,500	@ 0%	(dividends covered by Dividend Allowance)	0.00
32,000	Basic rate limit		
500	@ 0%	(further dividends covered by Dividend Allowance)	0.00
3,000	@ 32.5%	(dividends taxable at the dividend upper rate)	975.00
35,500			
Tax payable			£6,375.00

The taxpayer in this example has income within the higher rate band, but is not an additional rate taxpayer, and is thus entitled to a PSA of £500. As this individual has taxable non-savings income in excess of the £5,000 starting rate limit, the starting rate for savings cannot possibly apply to any of his income.

The example reflects the fact that dividend income is generally treated as the highest part of an individual's income, and savings income treated as the next highest.

'Savings income' will continue to be defined as now, with interest being by far the most common type of savings income in practice.

For Scottish taxpayers in 2016/17, and Welsh taxpayers in due course, liability to tax on savings income will be determined by reference to UK rates and UK rate thresholds.

A large number of consequential amendments to current income tax legislation are to be made as a result of the introduction of the PSA and the abolition of the duty of banks etc. to deduct basic rate income tax at source.

Article provided by Tolley Guidance

Personal service company update **(Lecture P934 – 15.02 minutes)**

Many individuals form a company through which they operate. The company invoices the end client for work done by the individual and then the individual extracts profit from their 'intermediary company' by way of low salary, high dividend, with the dividend often being shared between shareholding spouses.

However, where the individual, or his family, control more than 5% of the company then the personal service company regime needs to be considered.

To decide whether this regime applies, the individual needs to ignore the intermediary company and ask whether their relationship with the end customer is one of an employee or office holder? If it is, then any income from relevant engagements not paid out as salary is treated as a "deemed salary". This deemed salary is treated as if paid out as salary to the individual on 5 April with PAYE and NIC falling due.

The net effect of the rules is to reclassify dividend as salary thus reducing the savings from the intended low salary, high dividend extraction route.

Deemed salary calculation

The calculation of deemed salary is done at the end of the tax year as follows:

Income from relevant engagements (invoices where employee/ office holder relationship exists)	A
Less: 5% automatic deduction	(B)
	C
Less: Expenses paid by employer allowable as deductions from earnings if paid by an employee	(D)
Less: Employer pension contributions	(E)
Less: Employers NIC on workers actual salary and benefits (Class 1 and 1A)	(F)
Less: Actual salary and benefits paid	(G)
Gross deemed payment	H
Less: Employers NIC on gross payment (H × 13.8/113.8)	(I)
Net deemed payment (Deemed gross salary)	J

Points to note

Remember it is only the income from relevant engagements that are included in the net deemed salary calculation, so only where the employee/ office holder relationship exists. This income is subject to PAYE and national insurance that must be paid over to HMRC no later than 19 April, or 22 April if the payment is made electronically.

It is possible to make a provisional PAYE/ NI payment with any adjustments being reported via an Earlier Year Update submitted electronically to HMRC before the following 31 January.

Unfortunately, the £2,000 employment allowance is not available against the deemed salary secondary NIC.

Corporation tax implications for the intermediary company

All income invoiced will form part of the company's taxable profits while the deemed gross payment, plus employers NI, is deductible in arriving at the intermediary company's taxable profits. Deduction is allowed in the period in which the deemed payment is treated as made so, for a company with a 31 December year-end, the 5 April 2016 deemed payment is deductible in the year to 31 December 2016.

If dividends are paid, then there is a risk of double counting the income as both salary and dividends. If dividends are paid then the intermediary company needs to make a claim to set the deemed payments against the dividends paid (ITEPA 2003 s.58). If you are caught by the personal service company rules, it is much easier to stop drawing the dividends and take a salary instead.

<u>What's new?</u>

With effect from 6 April 2016, measures will be introduced which restrict the ability of certain temporary workers to claim relief from tax and National Insurance Contributions on expenses incurred in relation to home-to-work commuting. The intention is to ensure that such workers are subject to the established principle that relief is not applicable to travel between a worker's home and his/her permanent workplace (as opposed to a temporary workplace, where relief is available).

New ITEPA 2003 s 339A is to provide that, in the case of workers who personally provide their skills or labour through an "employment intermediary" (broadly an umbrella company, recruitment agency or employment business), each engagement is to be regarded as a separate employment for the purpose of the travel and subsistence expenses rules, so that each workplace will be treated as a permanent workplace. Thus, daily commuting by such workers will be regarded as ordinary home-to-work commuting and will not qualify for relief.

The measure does not, however, apply to a worker whose services are not subject to supervision, direction or control by another person.

The measure also applies to a worker operating through a personal service company which is required to operate the so-called **IR35** legislation under contracts where a deemed employment payment is made, or would be made were the worker not receiving all his/her income in the form of employment income. The "supervision, direction or control" provision does not apply in such cases.

So the key is to make sure that you are not caught by R35 by ensuring that contracts are drawn up carefully, containing the key characteristics of self-employment, especially an effective substitution clause.

Round up of payroll changes from April 2016 (Lecture P935 – 14.42 minutes)

There are four key changes affecting payroll from 6 April 2016.

<u>Removal of the £8,500 higher paid employee rule</u>

Currently, only directors and higher paid employees pay tax on benefits such as cars and medical insurance; employees earning less than £8,500 per annum are not taxed on such benefits. Historically, couples have been able to take advantage of this by employing the wife in the business in return for a small salary of say £5,000. As neither a director nor higher paid employee, she could then be given a company car tax-free – providing the benefit calculation does not put her above the £8,500.

From 6 April 2016, with the exception of ministers of religion, all employees will pay tax on all benefits and there is a new exemption for live in carers. Board and lodging provided on a reasonable scale at the home of the person they care for, will not be a taxable benefit.

Reimbursed expenses exemption

Currently, many employers have a dispensation in place for business expenses that are reimbursed to employees. Where no such dispensation exists, employers must report reimbursed expenses on the employees' P11d s and employees must record these amounts as benefits on their self assessment returns, making a claim on the return for the allowable cost element.

From 6 April 2016 dispensations are scrapped and a new statutory exemption is introduced for reimbursed business expenses. These amounts will not be reportable on the P11d nor by employees on their self-assessment returns.

The exemption applies to expenses that would attract a deduction under current legislation but it does not apply to salary sacrifice arrangements.

For the exemption to apply, there are two qualifying conditions that need to be satisfied:

1. Payer must operate a system to check that the employee is incurring and paying for the expenses
2. Neither the payer nor anyone operating the system knows or could reasonably know or suspect that expenses were not incurred or not deductible

Employers can apply to HMRC to reimburse expenses at a flat rate. Once approved, these flat rate amounts would also qualify for the reimbursed business expenses exemption.

Once the flat amounts are agreed, HMRC will issue an approval notice which will specify the:

- rate at which the expenses are to be paid or reimbursed
- date from which this takes effect (earliest date is the date of the notice)
- date of expiry (no more than 5 years after the date of commencement)
- type of expenses to which the approval notice applies.

HMRC will have the power to revoke these approval notices if an officer considers there is reason to do so and the revocation can be backdated to the date of approval.

Payrolling benefits

From April 2016, there is a new system of voluntary payrolling of benefits that will allow employers to report and account for tax on certain benefits and expenses via the RTI system rather than on Forms P9D or P11D. Cars, fuel, healthcare and gym subscriptions can all be included but beneficial loans, living accommodation and vouchers cannot be payrolled.

Employers who want to register for 2016/17 should do so via their government gateway by 5 April 2016.

Once registered, HMRC will identify the employees who are affected and will issue revised tax codes which exclude the payrolled benefits.

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.

How it works

This new system enables you to collect the tax due on benefits and expenses by adding a notional value to your payroll run.

Before making the first relevant payment to an employee in a tax year, you need to calculate the cash equivalent of the annual benefit (say a company car benefit of £3,000). You then need to determine the number of payments to be made to the employee in the tax year and divide the cash equivalent by the total number of payments to be made. So if paid monthly, divide the £3,000 car benefit by 12 to arrive at a notional value of £250 per month. This notional value is included in the monthly payroll for tax calculation purposes. The individual should not see any difference to their monthly tax as previously their coding reflected the car benefit.

All payrolled benefits are reported in your Full Payment Submission so no P11d or P46(Car) is needed but you do still need to complete Class 1A form P11d(b).

Trivial benefits

Currently employers can agree with HMRC that some benefits are trivial and need not be reported. However this can be burdensome for the employer and HMRC and is disproportionate to the tax and NIC that would be due.

From 6 April 2016 a statutory exemption is being introduced for trivial benefits. To qualify as a trivial benefit the following conditions must apply:

- The trivial benefit must not be cash or a cash-voucher (s.75 ITEPA 2003)
- The cost of providing the trivial benefit must not exceed £50
- The trivial benefit cannot be provided by way of a contractual obligation or salary sacrifice arrangement
- The trivial benefit must be given for a non-work reason e.g. birthday or social event

For close companies there is a £300 annual cap for directors and other office holders and family members but when those family members are also employees, they will get their own £300 annual cap.

Administration

Clear intention to pay under TTP agreement

Summary – The Tribunal found in favour of the taxpayer who clearly intended to pay via a TTP arrangement

In 2009/10 the taxpayer sold a farm asset with the intention of rolling over the gain. But, in January 2014, he notified HMRC that he had not reinvested the full proceeds. Two months later, the Revenue issued a revised capital gains tax assessment. The taxpayer was unable to raise the cash to pay the bill so he contacted the debt management unit with a view to making a time-to-pay arrangement. He paid part of the tax in May 2014 and the balance in October 2014.

HMRC issued a late payment surcharge in June 2014, against which the taxpayer appealed.

Decision:

The First-tier Tribunal said the taxpayer had acted "entirely reasonably". He had informed HMRC that a tax obligation had arisen because rollover relief was not fully available. The department's delay in responding had reduced the time for the tax to be paid within the time limit. The taxpayer had gone to a lot of trouble to raise finance to pay the tax, but this proved a slow process because of the information required. He paid £55,000 of the tax due when he was able and clearly intended to honour his obligations.

The tribunal concluded that the taxpayer had a reasonable excuse and allowed his appeal.

Comments – The case demonstrated how the tribunal will apply fairness in its judgement where there is evidence that the taxpayer took adequate efforts to adhere to the agreement that had been made with HMRC.

Duncan v HMRC TC4684

Serious illness was a reasonable excuse

Summary – The Tribunal found that the serious illness did form a reasonable excuse

The taxpayer filed its 2012/13 employer return on 19 November 2013, some six months late. HMRC imposed late filing penalties, against which the taxpayer appealed.

The taxpayer explained that the person responsible for submitting the return had had major surgery, leaving him unable to complete the return by the due date. This surgery had presented life-threatening complications which required him to stay in hospital during the relevant period. Thus he was unable to complete the form because of illness.

Decision:

The First-tier Tribunal found that the individual's illness had placed a great strain on the business's affairs. Evidence of the surgery had been provided and showed that it was "a very serious matter". On the balance of probabilities, the tribunal decided the taxpayer had a reasonable excuse for the late return.

The taxpayer's appeal was allowed.

Comments – HMRC may not regard serious illness as a reasonable excuse although it is normally regarded as such. Clearly the severity of the illness demonstrated it was a serious matter and consequently the Tribunal determined that it was a reasonable excuse.

Barr Brothers v HMRC TC4686

Sympathetic stance taken in relation to filing a CT return

Summary – The Tribunal found in favour of the taxpayer

In December 2013, the taxpayer received a notice to file a corporation tax return for 30 November 2013. HMRC claimed the form was not submitted by the deadline of 30 November 2014 and imposed a £500 penalty.

The company said the return had been filed and initially accepted by HMRC. However, because it was not in the proper iXBRL format, the department asked the taxpayer to re-submit the form and accounts again correctly. Until that was done, the company would not have met its filing obligations. The director wrote to HMRC with a copy of the accounts but no return, saying the company was having difficulty filing online.

Decision:

The First-tier Tribunal said the taxpayer had "made reasonable efforts to comply" with its obligations. Further it was "unfortunate" that HMRC had rejected the return. Although the deadline for the return was outside the two-year transitional arrangements for iXBRL, the taxpayer had faced "genuine obstacles" in filing online and had tried to contact HMRC for help.

On whether a penalty could arise when a return was rejected because the format was wrong, the tribunal concluded that, if "reasonable efforts" had been made to comply and there was a "reasonable belief" that the return had been filed correctly, the tribunal would be sympathetic to the taxpayer's case.

The taxpayer's appeal was allowed.

Comments – The taxpayer was able to demonstrate the difficulties of filing with a new process – Consequently the Tribunal held that as the taxpayer had made reasonable efforts to comply that a reasonable excuse was valid.

Activities Display Co Ltd v HMRC TC4718

Clients' obligation to file remains

Summary – The Tribunal found that just because the agent was elderly this did not stop the normal filing obligations being complied with

In an unusual case, several businesses appealed against late filing penalties on the basis that it was unlawful to require them to file their employer returns on line because their agent was elderly and did not use a computer.

HMRC applied to the First-tier Tribunal to have the cases struck out because their appeals had no prospect of success under rule 8(3)(c) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules No 2009/273.

The agent, B, said, as a result of the tribunal's decision in *LH Bishop Electric Co Ltd and others* (TC2910), he could not be forced to file returns on line because of his age — he was over 64 when the penalties were imposed.

He accused HMRC of “pursuing a vendetta against him” and wishing to put him out of business. The judge said the tribunal was not the place to air these complaints but, in any event, it did not appear to him that HMRC had behaved improperly.

Decision:

The judge was initially concerned whether the taxpayers were fully aware of the issue under appeal. The agent had made representations about his rights, whereas the appeal was intended to concern those of the taxpayers. However, given that the taxpayers had provided written authorisations, she concluded that they must have understood.

The tribunal found the taxpayers did not have a reasonable prospect of establishing a reasonable excuse. There was no explanation why they had not:

- appointed another agent who would file online;
- continued with B, but entered the figures electronically themselves; or
- subcontracted another agent to deal with online submissions while retaining B for other accountancy services.

The judge questioned why they would employ an agent who could not comply with the law on their behalf.

On whether the taxpayers could establish that they were not liable to file online, the judge said the entire tenor of B's complaint was it was a “breach of his human rights to require his clients to file online”. The judge dismissed this claim. She said the obligation on clients to file forms electronically affected all agents equally, but this requirement was intended to save the government money. If an exception were made for taxpayers who wanted to use elderly agents who did not use computers, anyone could avoid the duty to file online. Such an exception could not be justified.

The judge said B had no human rights case. In any event, the First-tier Tribunal was not the right forum for such a complaint. If B wished to pursue the matter he would need to take a case personally, but she did not think it could “possibly succeed”.

The judge concluded that the taxpayers' appeal that they should not be required to file online because they employed an elderly agent had no prospect of success. She suggested that some of the taxpayers might be able to apply for an exemption because of their age if they filed their own returns.

The appeals were struck out.

Comments - The judge concluded that the taxpayers' appeal that they should not be required to file online because they employed an elderly agent had no prospect of success. She suggested that some of the taxpayers might be able to apply for an exemption because of their age if they filed their own returns.

This last paragraph summed it all up. It was a hopeless case to start with as if it had been successful it would have been a perfect way for taxpayers to avoid obligations which clearly was not intended. Nice try but hopeless!

NT Organ and TL Bryant trading as Additional Aids (Mobility) and others v HMRC TC4704

Confused HMRC conduct benefits the taxpayer

Summary – The tribunal found in favour in part for the taxpayer because of HMRC behaviour in part

The taxpayer appealed against three late payment penalties for capital gains tax. The tax was due on 31 January 2013, and the penalty notices were dated 4 June and 14 August 2013, and 25 February 2014. He said HMRC had accepted an offer from him to pay the tax in two instalments on 31 March and 31 December 2013.

The Revenue said the agreement was to pay monthly, although the inspector agreed at the hearing that the arrangement had been for two instalments. As a result, it was agreed that the first two penalties were not due.

Decision:

The First-tier Tribunal noted that the taxpayer presented an "extremely thorough and organised set of evidence". HMRC were, however, "at best confused about what had and had not been agreed" and "at worst, disingenuous" about what they had written.

The judge said the final penalty was valid. The taxpayer had cancelled the time-to-pay arrangement on 30 December because he was unable to make the payment. He had proposed a new schedule but HMRC did not accept it. The taxpayer argued that HMRC accepted the payments when he made them, which, he said was implicit acceptance of the arrangement. The tribunal disagreed and said it was not within its jurisdiction to decide whether the rejection was unfair.

Finally, the tribunal confirmed that the penalty notices complied with UK law and had not breached the taxpayer's human rights.

The taxpayer's appeal was allowed for the first two penalties and dismissed on the third.

Comments - The FTT highlighted that the taxpayer, Mr Finch, presented "an extremely thorough and organised set of evidence and was a very credible witness. He had kept meticulous records of his correspondence with HMRC. HMRC, on the other hand, had been "at best confused about what had and had not been agreed", when payments were due and what arrangements were in place; and, at worst, disingenuous in its correspondence with Mr Finch. It is hardly surprising that they found in part in favour of the taxpayer and demonstrates how successful one can be armed with the appropriate evidence

S Finch v HMRC TC4734

Unfair treatment by HMRC

Summary – The Tribunal found the HMRC treatment to completely unfair

The taxpayer was granted options in a company unapproved employee share option scheme as part of his employment remuneration. The Revenue issued closure notices rejecting the taxpayer's claim for capital losses.

The taxpayer sought judicial review.

He argued first that he had a legitimate expectation that his loss claims would be considered in line with the Revenue's published 2003 guidance, *Tax treatment of options following Mansworth v Jelley*.

Second, the Revenue's refusal to recognise the loss claims and the decision to reverse the 2003 guidance with the publication of *Revenue and Customs Brief 30/09* amounted to an abuse of power. Third, the Revenue's refusal to recognise the claims had been a breach of the principle that the department should treat taxpayers fairly and consistently. The fact that other taxpayers in a similar position had been accorded treatment under the 2003 guidance meant he had not been treated fairly.

Decision:

Mrs Justice Whipple in the High Court said the authorities had established the general principle that the Revenue should be held to its published statements because the publication of those statements provided certainty among taxpayers and was part of the co-operative relationship between the Revenue and the public.

There were times when the Revenue could depart from such statements or rulings, but these had to be considered within the doctrine of legitimate expectation.

The duty to collect tax was a broad one and embedded within it was the obligation to treat taxpayers fairly. As a result, the Revenue could "be required in an appropriate case to continue to apply the wrong tax treatment to ensure consistency of treatment, where the alternative would be conspicuously unfair and an abuse of power".

The judge said there was an "obvious unfairness" in treating one set of taxpayers in the same position differently from another.

The application for judicial review was allowed. The judge remitted the matter to HMRC for reconsideration, taking into account all aspects of unfairness.

Comments – Mansworth v Jelley was a very unusual case involving bizarre facts and the history was confused as most readers will remember. The judge's comments were self-explanatory in light of HMRC's behaviour. It will be hoped that after appropriate reconsideration HMRC will decide in favour of the taxpayer. We shall have to see whether this reappears in the courts.

R (on the application of Hely-Hutchinson) v CRC, Queen's Bench Division

Was a claim made in a return?

Summary - The FTT found that the company had made a valid claim in its tax return. Therefore the closure notice issued by HMRC was effective in denying it.

Spring Salmon was entitled to intangibles relief in respect of goodwill acquired in July 2002. The company made a terminal loss relief claim impacting the 2004 period and the 2005 period. If the claim was made in the 2004 or the 2005 return, the closure notices were effective to deny the relief. If the claim was not made in a return, any enquiry should have been opened under TMA 1970 Sch 1A, so that the closure notices were ineffective to deny relief.

Decision:

In both returns, the section (box 30) to be completed for trading losses was blank. The FTT highlighted, however, that the tax properly chargeable in the year to which the respective returns related could not be understood without the computation, letter and financial documents supplied by the company. The claim was therefore included in the 2004/05 return.

Finally, the closure notices, which referred to the company's accounts and computations (which included the goodwill amortisation) disallowed the relief and therefore the claim. The FTT emphasised that it was not necessary for the notices to make express reference to the terminal loss claim.

Comments – Readers will recognise the name of the appellant in this case as the taxpayers have been carrying on a war of attrition against HMRC for some time. The company had made a valid claim in a return – Therefore this worked against it the consequence was that the closure notice denying it was valid.

Spring Salmon & Seafood v HMRC [2015] UKFTT 616

Repayment supplement payable by HMRC

Summary - The FTT found that a repayment supplement was payable by HMRC.

Marlico had made a claim for a repayment supplement in relation to a VAT repayment, under VATA 1994 s 79. Marlico claimed that the repayment made by HMRC was subject to unreasonable delay, having been made after 76 days. This was beyond the 30 days of reasonable inquiry time given to HMRC under s 79(3). The dispute therefore focused on when the 30 day inquiry window should be treated as both commencing and ending.

Decision:

It was agreed that the 30 day period had begun on 7 March 2013, with the receipt of the claim by HMRC. The FTT explained that the clock would only have stopped running when HMRC had formulated a specific question which it required Marlico to answer. This had in fact happened on 22 March, when HMRC had sent a letter to Marlico. However, it had not been reasonable for HMRC to ask for this information, as HMRC should have known that Marlico could not hold the information. It was only after 26 April 2013 that HMRC had accepted alternative information. The 'stopping clock' period had therefore only started then and had run until HMRC had confirmed that it had received complete answers on 9 May 2013. Payment was then deemed to have been made on the day it was instructed by HMRC, 17 May, and not on the day it was received by Marlico.

The FTT concluded that the total amount of time from receipt of the VAT claim until payment had been instructed by HMRC was 58 days excluding HMRC's 'reasonable inquiry' time. This was well in excess of the 30 day period available to HMRC under s 79 and a repayment supplement was therefore due.

Comments – The case demonstrates the importance of knowing the exact dates that correspondence, payments etc have been in determining what interest consequences follow. The case is also a reminder that HMRC need to be diligent in dealing with repayment claims and if they are not, taxpayers should hold them to account, with the support of the Tribunal system if necessary.

Marlico v HMRC [2015] UKFTT 528

Deadline Dates

1 January 2016

- Due date of payment of corporation tax liabilities for accounting periods ended 31 March 2015 for small and medium-sized companies not liable to pay by instalments.

7 January 2016

- Due date for filing of VAT returns and payment for 30 November 2015 quarter (electronic payment).

14 January 2016

- Forms CT61 to be submitted and tax paid for the quarter ended 31 December 2015 by this date.
- Quarterly corporation tax instalment due for large companies depending on accounting year end.

19 January 2016

- Payment due for PAYE, NIC, CIS and student loan liabilities for month ended 5 January 2016 if not paying electronically.
- Filing of monthly construction industry scheme return is due.
- Payment of PAYE liability is due for quarter ended 5 January 2016 if average monthly liability is less than £1,500.

21 January 2016

- Filing of online monthly EC sales list is due.
- Submit supplementary intrastat declarations due for December 2015.

22 January 2016

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

31 January 2016

- The electronic filing date for 2014/15 personal, partnership and trust self-assessment (SA) tax returns.
- Deadline for various claims for relevant tax year.
- Balance of the 2014/15 SA liabilities is due on this date.
- Due date for payment of first instalment of 2015/16 SA liabilities including Class 2 NICs.
- 2013/14 SA tax returns should be amended by this date.
- Companies House should have received accounts of private companies with 30 April 2015 year ends and public limited companies with 31 July 2015 year ends.
- HMRC should now have received corporation tax self-assessment returns for companies with accounting periods ended 31 January 2015.

HMRC News

HMRC responds to petition from 38 Degrees

HMRC has responded to a petition on National Minimum Wage from 38 Degrees.

An HMRC spokesperson said:

While we don't discuss individual cases we always investigate businesses where we believe they are not paying the National Minimum Wage (NMW). We act on information from a range of sources, including workers, third parties or from our own proactive work to gather intelligence.

Where a company is not paying the NMW we have a proven track record for taking firm action and will continue to do so. Since April this year alone we have taken action against 557 businesses, clawing back over £8 million for 46,000 workers who had been illegally underpaid.

Actions taken:

- Since April this year we took action against 557 businesses and clawed back £8 million for 46,000 workers who had been illegally underpaid.
- Since the introduction of the NMW in 1999, HMRC has completed over 69,000 NMW investigations and identified over £65 million arrears of pay for over 300,000 workers who had been illegally underpaid.
- We currently have 1557 investigations underway across the UK.

The Scottish rate of Income Tax

The Scottish rate of Income Tax was introduced in the Scotland Act 2012 and will start on 6 April 2016.

The Scottish Government has proposed that the Scottish rate will be 10% for the tax year 2016 to 2017.

What Scottish taxpayers will pay?

UK Income Tax rates will be reduced by 10 percentage points for people living in Scotland. You'll then pay the Scottish rate of 10% on top of your UK rate.

For example, if you pay tax at the basic rate of 20% this will reduced to 10%. You'll then pay the Scottish rate of 10% on top of this, giving a total of 20%. There is no overall change to the Income Tax rate you pay – whether you pay the basic, higher or additional rates. But some of the Income Tax collected under the Scottish rate will fund the Scottish government, and the rest will fund the UK government.

The Scottish rate of Income Tax doesn't apply to income from savings such as building society interest or income from dividends. This rate will stay the same for all taxpayers across the UK. HM Revenue and Customs (HMRC) will collect the Scottish rate of Income Tax on behalf of the Scottish government.

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

Identifying Scottish taxpayers

It's where you live, not where you work, that decides whether you're a Scottish taxpayer. If you live in one place during a tax year, and it's in Scotland, you'll be a Scottish taxpayer. If you live anywhere else you won't be.

If you move to or from Scotland, have more than one home, or don't have a home, you'll need to work out if you're a Scottish taxpayer.

You can only be a Scottish taxpayer if you're resident in the UK for tax purposes.

If the address HMRC holds for you is in Scotland, you'll be sent a letter to check your address is correct. These letters started to go out on 2 December 2015.

You'll be classed as a Scottish taxpayer if the address HMRC holds for you is in Scotland. It's your responsibility (not your employers') to notify HMRC if you change your address. Your April 2016 tax code will begin with the letter 'S' to show you're a Scottish taxpayer. If you pay your Income Tax through your wages, HMRC will advise your employer to treat you as a Scottish taxpayer so you don't need to do anything. If you fill in a Self-Assessment tax return you'll declare if you're a Scottish taxpayer on the return.

Employers and Pension Providers

HM Revenue and Customs (HMRC) will identify who'll be a Scottish taxpayer. Employers and pension providers don't need to decide this and should only use a Scottish tax code if HMRC tell them to. If your employee or pension scheme member disagrees with their tax code ask them to read the guidance on the Scottish rate of Income Tax before contacting HMRC.

You won't need to change how you report or make payments for Income Tax to HMRC other than to apply the Scottish rate of Income Tax code to your Scottish taxpayer employees. You must still apply the Scottish tax code for a Scottish taxpayer even though, overall, the amount of tax they pay isn't changing.

PAYE forms and payslips

Forms P6 and P9 will be amended to show the correct tax code for UK and Scottish taxpayers. You'll need to adjust your IT systems to collect the correct amount. If you're given a P45 with a Scottish tax code follow the current process. If a new starter doesn't give you a P45, or you're unsure which tax code to use, use the rest of the UK tax code and rate. HMRC will tell you if you need to change the tax code. You won't need to show the Scottish rate separately on the P60 or payslips but they should show a Scottish tax code.

Calculations

The current process for week 1/month 1 won't change and HMRC will tell you which tax code to use. Apply the code to their income for the year to date. Any resulting under or overpayments will usually be corrected in-year.

From 6 April 2015, the 50% overriding limit for PAYE deductions will apply to both UK and to Scottish rate tax calculations. Scottish tax tables will be provided for Scottish tax codes.

Employee or pension scheme member changes address

If an employee changes their address in year, HMRC will reassess their taxpayer status and reconcile their tax using the current processes. Make sure your employees or pension scheme members know they need to tell HMRC if they change their address, to ensure that they're given the correct tax code.

PAYE Settlement Agreements (PSA)

From tax year 2016 to 2017 you'll need to account for both UK and Scottish rates of Income Tax for a PSA. The relevant forms and guidance will be updated nearer the time. You'll need to use the relevant tax rates (UK or Scottish) to work out the correct tax due.

Pension Relief at Source (RAS)

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

Until then all RAS claims will be made at the UK basic rate. Any adjustments that might be needed will be made by HMRC through Self Assessment or through PAYE coding.

Pension schemes operating net pay

If you're operating a net pay arrangement pension scheme you'll deduct pension contributions from your employee's gross pay giving them full relief at the appropriate Income Tax rate.

Return your Self-Assessment and find your inner peace

HMRC is urging all customers to file their Self-Assessment tax return before the 31 January deadline.

The deadline for 2014-15 Self-Assessment filing is fast approaching and HMRC is urging all customers to find their inner peace by returning theirs before 31 January!

More than 85% of customers chose to submit their return online last year. The service is quick, easy and has a wide range of support resources available, such as web chat. If you're filing online for the first time, you will need to register for an activation code, which will be posted to you. This can take a few days, so you'll need to allow time for this. Remember – you have to file and pay any tax owed by the 31 January to avoid paying a penalty or interest on any tax paid late.

This year we are giving more than one million Self- Assessment customers access to their own Digital Tax Account for the first time. This is an online service personal to each individual customer, allowing them see how their tax is calculated, update personal details and access all their tax information in one space, just like online banking.

Ruth Owen, Director General, Personal Tax, HMRC said:

> The 31 January deadline will soon be here. And while it's tempting to put completion of your tax return to the bottom of the 'to do' list at this time of year, it's not something I would recommend if you want to avoid a last minute rush in January. We have improved our online services again this year to help our customers get their tax right quickly, simply and securely.

Business Taxation

Not too small to be ignored when there is no de minimis with EIS

Summary – The Tribunal found against the taxpayer in that preferential rights attaching to ordinary shares could not be ignored for enterprise investment scheme (EIS) purposes

The taxpayer developed and delivered digital content to cinemas. To raise funds from the shareholders, the company issued ordinary shares carrying a small preferential right. The company applied for a compliance certificate so that its investors could obtain enterprise investment scheme (EIS) relief.

However, under ITA 2007, s 173(2)(aa), EIS relief is not available if the shares acquired carry "any present or future preferential right to a company's assets on its winding-up". HMRC therefore refused the application.

The taxpayer appealed. Counsel for the company argued that the shares carried "the overwhelming majority of the risk and reward in the company's business". They were the kind of shares parliament intended to benefit from EIS relief. Further, under the de minimis rule that applied as an aid to the construction of UK statute, the preferential right was so small that it could be ignored in determining whether the shares contained one.

Decision:

The First-tier Tribunal said that, although lawyers may be aware of the de minimis principle, it was unlikely that directors of a company claiming EIS would be aware of it. So if parliament had intended that a company could "properly make a compliance statement even if the shares being issued carried some, albeit small, preferential rights", it would have said so "expressly".

The tribunal concluded that the preferential right attaching to the shares could not be ignored just because it was small.

The taxpayer's appeal was dismissed.

Comments – Although there is a principle involving the concept of de minimis amounts that could be ignored in interpretation the problem was that there was no de minimis principle recognised in the EIS legislation.

Flix Innovations v HMRC TC4710

Expectation of profit not shown so loss relief lost

Summary – The Tribunal found against the taxpayer in respect of relief for farming losses

The taxpayer was a farmer who had run at a loss since 2002/03. His income was supplemented by rental income from a tenant who quarried part of the farmland and excavated gravel.

The taxpayer claimed relief for his farming losses against his rental income and capital gains arising from the disposal of part of his farm.

Citing ITA 2007, s 67(2), HMRC refused the claim, saying loss relief was not due because he had made losses in the previous five years and had no reasonable expectation of profit (s 67(3)).

The taxpayer appealed.

Decision:

The First-tier Tribunal said that, under ITTOIA 2005, s 12 and s 335, profits arising from concerns, such as mines and quarries, were taxed as if they were from trades even though the source of the profits was the land. The taxpayer's rental income fell into this category and could therefore not be part of his general trading income. It was instead chargeable to tax under ITTOIA 2005, s 335 as property income.

On sideways loss relief, the taxpayer had provided no evidence that he intended to make a profit in future years. He had been managing on his rental income and by selling parts of his land, and could not be regarded as having a reasonable expectation of profit. The judge accepted that he was not a hobby farmer, but said the restriction in s 67(3) applied.

The taxpayer's appeal was dismissed.

Comments – This is the second case in the last couple of months relating to the relief for farming losses both involving albeit slightly different situations where losses had been made for more than five years. The farmers involved should have known the provisions involved but did not and the Tribunal applied the provisions fairly which meant that both appeals failed.

J Henderson v HMRC TC4730

Whether loan relationship had unallowable purpose

Summary - The FTT held that the loan relationship unallowable purpose rules applied to disallow debits arising with regard to a fair value loss on a deemed loan relationship in connection with a tax avoidance scheme.

The First Appellant, Travel Document Services Ltd, entered into a complex tax avoidance scheme which brought its holding of a subsidiary company's shares within the loan relationship rules by entering into a derivative contract in the form of a total return swap and subsequently depressed the value of the shares by novating a loan liability into the subsidiary from another group company. The effect was to accrue a loan relationship debit in the First Appellant by reference to the reduction in the fair value of the subsidiary's shares. The subsidiary (the Second Appellant, Ladbroke Group International Ltd) accrued conventional loan relationship debits as a result of its liability to interest on the loans novated to it. It is worth noting at the outset that the provisions of FA 1996, s. 91B were triggered by the entering into of the swap.

It was accepted that the provisions of FA 1996, s. 91B applied to deem the shareholding in the subsidiary as a creditor loan relationship. The appeal essentially involved a consideration of whether the loan relationship unallowable purpose rules in FA 1996, Sch. 9, para. 13 applied to a deemed loan relationship in the same way as they applied to an actual loan relationship.

The taxpayer essentially argued that it would make no sense to attribute its motives for holding the underlying shareholding in the subsidiary as being its motive for holding a deemed loan relationship because it could not have a motive for holding something it did not in fact own.

Decision:

Although both the taxpayer and HMRC argued that it was necessary to ascertain the First Appellant's motive for holding the subsidiary's shares, the Tribunal held that on any rational analysis, The First Appellant's purposes in causing the satisfaction of the provisions of FA 1996, s. 91B must be treated as being its purposes for being party to the deemed loan relationship. These provisions were satisfied by entering into the swap therefore the motive for entering into the swap was the appropriate test under the legislation. Because the First Appellant had already accepted one of the main motives for entering into the swap was to facilitate the tax advantage, it followed that the First Appellant had an unallowable purpose thoughout the period in which it was deemed to hold the loan relationship by virtue of FA 1996, s. 91B. Considering the legislation in the round it was appropriate that the general scheme and policy of an anti-avoidance provision, which had been carefully phrased in quite broad and general terms should apply to what might be called deemed loan relationships.

With regard to the Second Appellant, the FTT judged, on the basis of the facts, that the loan relationship debits arising to the Second Appellant also had an unallowable purpose. These debits related to an actual loan relationship not a deemed loan relationship therefore it was not necessary to consider the *deemed* loan relationship point above.

With regard to the amount of each debit which should be attributed to the unallowable purpose, the FTT judged, in the case of both taxpayers, that the whole of the debits arising should be attributable to the unallowable purpose, notwithstanding that this gave rise to an assymetric tax disadvantage to the group as a whole. In this regard, the legislation simply did not require symmetry of treatment.

Comments - This judgment represents another taxpayer defeat in an increasing line of tax avoidance schemes designed to exploit aspects of the loan relationship rules. The specific rules in point were the Shares with Guaranteed Returns etc. anti-avoidance provisions of FA 1996, s. 91B however the real focus of the judgement is on the loan relationship unallowable purpose rules and, in particular, the principle that deemed loan relationships should be treated for the purposes of these rules in the same way as actual loan relationships.

Unlike the provisions of FA 1996, s. 91B which were repealed with effect from 22 April 2009, the unallowable purpose rules still apply and will continue to apply for accounting periods beginning on or after 1 January 2016 when the loan relationship modernisation changes in Finance (No. 2) Act 2015 take effect.

Travel Document Service and Ladbroke Group International v HMRC TC4728

Company Distributions - Consultation document

From April 2016, the way in which dividends (and other company distributions) are taxed will be fundamentally reformed for individual recipients. The changes will increase the incentive to arrange for returns from a company to be taxed as capital rather as than income, attracting tax at lower Capital Gains Tax rates, rather than the new dividend tax rates.

The government believes that it is unfair that some people can, in some cases, arrange their affairs solely to take advantage of lower tax rates.

This consultation accompanies draft legislation designed to prevent tax advantages being obtained from specific types of behaviour. The proposed legislation would:

- amend the Transactions in Securities legislation, which is designed to prevent unfair tax advantages in certain circumstances. The amendments would strengthen these rules, and clarify certain areas; and
- introduce a new Targeted Anti-Avoidance Rule, which would prevent some distributions in a winding-up being taxed as capital, where certain conditions are met and there is an intention to gain a tax advantage.

The consultation invites comments on what effect these changes might have, as well as inviting suggestions about how the problem might be addressed more widely.

Finally, the government seeks views on whether respondents think that a more far-reaching review of the distributions rules might be beneficial, and if so what might be included.

This consultation and the new rules it discusses do not cover distributions received by companies.

The Abolition of Class 2 NICS - Consultation

The 2015 Summer Budget confirmed the government’s intention to abolish Class 2 National Insurance contributions (NICs). This means that instead of paying two classes of NICs (Class 2 and Class 4), the self-employed will pay just one (Class 4) in the future. This follows the recommendations of the Office of Tax Simplification.

Class 2 NICs currently provides the self-employed with access to a range of state benefits.To ensure that the self-employed can continue to access these benefits through the NICs system, this consultation considers how self-employed individuals could build entitlement through Class 4 NICs. It also identifies where alternative options will be considered for those who would be unable to maintain benefit entitlement under a Class 4 NICs entitlement test.

The government recognises that this is a complex area. Because of the importance of getting the detail right in this reform, no timetable has been set for the abolition of Class 2 and the reform of Class 4. The government welcomes views on the potential approaches proposed and on alternative options.

This is intended to a summary of the main options. There are more details with examples in the actual consultation document itself.

Abolishing Class 2 NICs and reforming Class 4 NICs to introduce a new contributory benefit test

The abolition of Class 2 NICs requires the introduction of a new contributory benefit test for the self-employed. This consultation sets out the government’s proposal to introduce a contributory test based on profits into Class 4 NICs.

This means those with annual profits equal to or above a certain level could accrue qualifying years for entitlement to the State Pension and meet the new contributions tests for other contributory benefits through Class 4 NICs.

The government will consider responses before confirming whether and how it would introduce such a test to determine benefit entitlement.

Taking account of existing provisions in the NICs and wider welfare system, the government will use the consultation responses to consider how to provide for those groups:

- who could not meet the conditions of the new benefit tests through a Class 4 profits test (the issue of Maternity Allowance access is discussed in chapter 3)
- for whom current Class 2 rules confer special treatment (discussed in chapter 5)

The abolition of Class 2 NICs and the reform of Class 4 NICs will not be implemented until April 2017 at the earliest.

Responses to the consultation will be used to inform the government's decision on how and when to proceed with the abolition of Class 2.

Objectives for reform

The objectives of this reform are to:

- deliver genuine simplification for self-employed NICs payers, making self-employed NICs more transparent and easier to understand
- make sure self-employed individuals have access to contributory benefits via the NICs system
- align the treatment of different self-employed NICs payers wherever possible, so contributory benefits can be accessed on a more equal basis to make the system fairer for all
- simplify the administration of self-employed NICs

In delivering these objectives, the government will seek to ensure that:

- the contributory principle is retained in the National Insurance system for self-employed people
- no-one loses access to the State Pension
- any changes to the benefit entitlement tests maintain access to Maternity Allowance

Purpose and scope of this consultation

This consultation sets out the proposed structure for Class 4 NICs as a mechanism for determining benefit entitlement that would follow Class 2 abolition.

It explores how access to contributory benefits could be determined using an annual profits test in Class 4 NICs and how those who may not gain access through Class 4 would be affected

An individual who has already been awarded benefits based on the existing contributory rules and conditions will not be affected by the move to these new tests for the duration of their existing award.

A reformed Class 4 NICs and an annual profits test

This chapter explores how a contributory benefit test based on profits in Class 4 NICs could work and how this could determine access to contributory benefits for the self-employed.

It explains how self-employed people would be affected by these proposals, noting how existing provisions in the NICs system could protect the State Pension record of those who may not meet the conditions of a profits test.

It notes that there are no similar provisions for working age benefits, and so confirms that the government will consider whether and how to enable the self-employed to continue to access these benefits based on voluntary contributions.

The impact of Class 2 abolition on access to Maternity Allowance is discussed later.

The proposals ensure that self-employed individuals can continue to build benefit entitlement through the NICs system, and that no-one would lose access to the State Pension as a result.

These are the government's proposals only; it has not made any final decisions on how to abolish Class 2 NICs or reform Class 4 NICs.

The proposed structure of Class 4 NICs

To simplify NICs for the self-employed, the government will abolish Class 2 NICs and introduce a new contributory benefit test into Class 4 NICs. To do this, the government proposes to:

- create a new zero-rate band of Class 4 NICs on annual profits between the Small Profits Threshold (SPT, currently £5,965) – the point at which Class 2 is currently liable to be paid – and the Lower Profits Limit (LPL, currently £8,060) – the point at which Class 4 becomes payable
- change the contribution conditions attached to the State Pension and other contributory benefits to enable Class 4 NICs (including those at the new zero-rate) to count towards benefit entitlement, so that self-employed individuals with annual profits at or over the Small Profits Threshold would be able to accrue qualifying years (QYs) for benefit entitlement
- align the SPT with the weekly Lower Earnings Limit (LEL) in Class 1: Primary (employee) NICs, by setting the SPT at 52 times the LEL.

How a profits test would confer contributory benefit entitlement

As noted above, the abolition of Class 2 NICs and the introduction of a contributory benefit entitlement test based on annual profits subject to Class 4 NICs means that the current contributory benefit entitlement tests would need to change.

The current tests for the self-employed are based on payment of weekly Class 2 NICs. They differ based on the actual benefit being claimed. For the State Pension, 52 Class 2NICs are normally required to achieve a qualifying year towards the State Pension.

Class 2 NICs can be combined with Class 1 NICs and National Insurance credits (NI credits) and in some cases Class 3 (voluntary NICs) to achieve the 52 required.

Class 2 NICs can also be combined with Class 1 NICs for the purposes of entitlement to Bereavement Benefit (which will be replaced by Bereavement Support Payment from April 2017), Employment and Support Allowance and Maternity Allowance.

The introduction of a profits test into Class 4 would mean that the new contributory benefit tests for the self-employed would operate on the basis that annual profits at or over the Small Profits Threshold in Class 4 NICs (circa £6,000 on introduction) confer one qualifying year towards benefit entitlement.

Benefits and tests

Benefit	**Current entitlement tests**	**How this could change under Class 4 profits test**
New State Pension (from April 2016)	For those contributing for the first time under the new system, 35 x qualifying years are required to be entitled to the full amount on reaching State Pension age (a minimum of 10 qualifying years needed to be entitled to any State Pension)	No change required to the existing qualifying year rules
Bereavement Support Payment (from April 2017)	26 weeks of Class 2 contributions in any one tax year	1 qualifying year in any past year
Contributory Employment and Support Allowance	26 weeks x Class 2 NICs in one of the previous two tax years and 50 weeks x Class 2 NICs or NI credits during both of the previous two tax years (which immediately precede the beginning of the benefit year in which a claim is made)	1 qualifying year in one of the past 2 last recorded [1] tax years and 1 qualifying year or 50 Class 1 NI credits in both of the previous two tax years

Impact on the self-employed with sufficient Class 4 profits or Class 1 earnings

The approach proposed above means that, following the abolition of Class 2 NICs, self-employed people with annual profits at or above the Small Profits Threshold (SPT) would build up their entitlement to contributory benefits automatically through Class 4 NICs.

Those with profits between the SPT and Lower Profits Limit (LPL) (£8,060 in 2015/16) would no longer pay any NICs but still build entitlement to contributory benefits.

A Class 4 NICs zero-rate band would protect the benefit entitlement position of those with profits between the SPT (inclusive) and the LPL in a similar way that the structure of Class 1 NICs protects the benefit entitlement of those employees with earnings between the Lower Earnings Limit (LEL) and Primary Threshold (PT).

Indeed this approach would mirror the structure of Class 1 NICs for company directors who have an annual earning period (except for when they first become a director, when it is pro-rata).

Those whose profits are below the SPT but who have employment earnings may be able to accrue qualifying years for benefit entitlement via Class 1 NICs. To gain a qualifying year, an individual needs to have annual earnings above £5,824, made up of earnings between the Lower Earnings Limit (LEL, £112 per week in 2015/16) and the Upper Earnings Limit (UEL, £815 per week in 2015/16).

Broadly, this means that a self-employed individual with low profits who also has a job from which they earned at least this amount during the tax year, would see no impact on their benefit entitlement position from the introduction of a Class 4 profits test.

They would not be liable for Class 4 NICs but would pay (or be treated as paying) Class 1NICs on their employment earnings.

Impact on the self-employed without sufficient Class 4 profits or Class 1 earnings

Following the abolition of Class 2 NICs and the introduction of a profits test into Class 4, those with profits below the SPT and who have insufficient earnings from employment would need to accrue qualifying years for benefit entitlement in another way.

The impact of the proposed approach on the benefit position of those with profits below the SPT who have multiple sources of earnings – where each source of earnings falls below the qualifying annual threshold – within a single tax year is more complex.

The impact that this reform would have on entitlement to the State Pension is different to the impact on entitlement to other benefits. These different impacts are discussed in turn.

State Pension entitlement

Following these reforms, those with profits below the SPT would need to make use of the existing provisions in the NICs system that serve to protect an individual's State Pension record, in the same way as for employees who do not gain entitlement through Class 1 NICs. These are NI credits and Class 3 voluntary contributions.

National Insurance credits

Those self-employed people with profits below the SPT but who are eligible for National Insurance credits (NI credits) would continue to accrue qualifying years for the State Pension.

Class 3 voluntary contributions

Self-employed individuals with profits below the Small Profits Threshold (SPT) who are ineligible for NI credits and who wish to fill gaps in their contribution record for the State Pension would need to pay voluntary Class 3 contributions.

While the Government recognises that the rate of Class 3 contributions is higher than Class 2 contributions, those for whom Class 3 may be prohibitively expensive may be eligible to claim means-tested benefits, which would protect their State Pension record via NI credits.

Prior to April 2000, the Class 2 rate of NICs was 10 pence higher than the Class 3 rate, because of this wider range of contributory benefits that it entitles the payer to receive. However, the Class 2 rate was considerably reduced in 2000 to lessen the cost of Class 2 for those self-employed individuals for whom it was compulsory.

Having a single class of voluntary NICs corresponds with the introduction of the new State Pension in April 2016. This will treat contributions from employees and the self-employed (and NI credits) on an equal basis. This supports the case for having a one class of voluntary NICs for building State Pension entitlement.

As is the case currently, self-employed individuals would be able to check their National Insurance record before deciding whether they want to pay Class 3 NICs. For those contributing for the first time under the new system, individuals with 35 qualifying years (QYs) over their working life will be entitled to claim the full new State Pension on reaching State Pension age; those with fewer than 35 would receive less than the full rate.

This means that those whose profits are below the SPT in only a small number of years may not need to pay Class 3 NICs to fill gaps. It is those with successive years of low profits who may see their State Pension entitlement affected if they did not pay Class 3NICs.

Entitlement to Bereavement Support Payment and contributory Employment and Support Allowance

Class 2 NICs can currently be paid voluntarily by those with low profits to protect their benefit entitlement. In addition to the State Pension, payment of Class 2 NICs protects entitlement to contributory Employment and Support Allowance (c-ESA) and Bereavement Benefits (BB) / Bereavement Support Payment (BSP) (from April 2017).

Following the abolition of Class 2 NICs and the introduction of a profits test into Class 4 NICs, an individual with profits under the SPT would be able to protect their State Pension record through Class 3 voluntary NICs (or NI credits).

However, because c-ESA and (from April 2017) BSP are only currently accessible to the self-employed via Class 2 NICs, the removal of the ability to access contributory benefits based on voluntary contributions could have an impact on a self-employed individual’s entitlement to these benefits.

Access to Maternity Allowance

Maternity Allowance (MA) is not a contributory benefit. The current entitlement tests are two-fold: an employment test and an earnings test. For self-employed women, the employment test is to ensure that the claimant has been recently self-employed prior to claiming MA, and the earnings test determines the rate at which MA is paid.

The earnings test for self-employed women is based on payment of Class 2 NICs; sufficient Class 2 payments confers access to MA paid at the standard rate. Access to MA for women who participate in the self-employed business of their spouse or civil partner is also based on the spouse's / civil partner's Class 2 NICs record.

Following the abolition of Class 2 NICs, the employment test set out above would remain in place. However, a new 'earnings test' would be required for MA purposes.

In line with the government's objectives set out in chapter 1, the government seeks to ensure that any changes to the benefit entitlement tests maintain access to Maternity Allowance.

As with the tests proposed for other benefits, the government will consider all responses to the consultation before making its final decision on how self-employed women – and women who participate in the self-employed business of their spouse or civil partner – would access MA after Class 2 is abolished.

Maternity Allowance for self-employed women

The government is considering two options for Maternity Allowance access for self-employed women. Option 1 looks to build on existing systems in the NICs system to facilitate MA entitlement, while Option 2 looks to move the qualifying rules for self-employed women more closely to those currently used for employed claimants of MA.

- Option 1: An earnings test based on a profits test in Class 4 NICs (with an option to purchase Class 3 voluntarily)
- Option 2: Entitlement based on estimated earnings

Maternity Allowance for women who participate in self-employed business of their spouse /civil partner

A similar approach to Option 1 could be taken for the MA earnings test for women who participate in the self-employed business of their spouse or civil partner.

Self-employed people with multiple sources of earnings

Contributory benefit entitlement is based on earnings (using Class 1 NICs), payment of Class 2 or 3 NICs, and/or NI credits. These classes of NICs operate on a weekly basis, and can be combined together for the purposes of benefit entitlement.

For the 2015-16 tax year, employees need to have earnings which are at or above the annual equivalent of the Class 1 Lower Earnings Limit (LEL) of £5,824 (52 x the weekly LEL of £112) for the year to gain a qualifying year for State Pension purposes.

Where an individual is both employed and self-employed, this figure of £5,824 can be made up of a combination of earnings and Class 2 NICs. Each weekly Class 2 contribution (and each weekly Class 3 contribution or NI credit) is equivalent to the weekly LEL of £112.

Class 4 NICs does not operate on a weekly basis; it is an annual charge on self-employed profits. It cannot currently be combined with other classes of NICs for benefit purposes.

Therefore, the government needs to consider the particular impact of a test based on annual profits on self-employed people with multiple sources of earned income.

Those individuals with earnings below the LEL throughout the year and profits from self-employment below the SPT may have combined earnings from employment and profits from self-employment that exceed the qualifying threshold of £5,824, but they will not qualify for contributory benefits.

This is because NICs operates on a per employment basis; NICs cannot be aggregated into a single total amount of annual earnings. These individuals would currently need to pay Class 2 voluntarily for the whole year if they wanted to protect their benefit position.

Those self-employed people with low annual profits whose NI credits cease during the year, such as when a benefit claim ends or when their youngest child turns 12, can also pay Class 2 voluntarily, like those moving between employment and self-employment as shown in Example D.

As with the State Pension position of employees who have earnings below the LEL, a self-employed individual's future State Pension would only be materially affected if these situations occurred in multiple tax years during an individual's working life.

In these cases, individuals would be able to pay Class 3 voluntary NICs retrospectively to fill gaps in their State Pension record.

There could however be an impact on access to other benefits, in the same way that other individuals in certain circumstances would be affected by the abolition of Class 2.

As previously noted, the government is considering whether and how to retain the ability of self-employed individuals to build access on a voluntary basis to working age benefits. It will take account of the potential impact on individuals in these situations before making a final decision on the new benefit tests for the self-employed.

The government will also consider enabling individuals who move from employment to self-employment (and vice versa) during the year to pro-rata their self-employed profits into weeks when filing their self-assessment return, to accord with the period of self-employment. If these 'weekly profits' are at or more than the level of the LEL (of £112 in 2015/16), these would confer benefit entitlement for those weeks.

These could then be combined with other weeks in which Class 1 contributions were made, or with Class 3 voluntary NICs, to reach a qualifying year.

There are other details relating to special groups of class 2 NICs payers

Accounts and tax computations under new UK GAAP (Lecture B931 – 15.12 minutes)

Currently companies are required to prepare accounts in accordance with the formats of the Companies Act. FRS 102 makes some changes to the form and content of accounts, while allowing the retention of their existing titles.

Current UK GAAP	FRS 102
Profit and loss account	Income statement
Statement of total recognised gains and losses	Statement of comprehensive income
Balance sheet	Statement of financial position
Cash flow statement	Statement of cash flows
Movement on reserves	Statement of changes in equity
Notes	Notes

It is essential to appreciate that these statements are not identical or synonymous!

The following examples illustrate these changes:

(a) The revaluation of investment properties currently is recognised within the Statement of Total Recognised Gains and Losses (STRGL), which FRS 102 refers to as Statement of Other Comprehensive Income, whereas under FRS 102 such gains are recognised in what we traditionally refer to as Profit and Loss Account but FRS 102 calls the Income Statement;

This change will, of course affect the tax computation, since you will need to deduct such revaluation gains as they will not be taxable until the investment property is sold.

However, FRS 102 requires deferred tax to be provided on such revaluation surpluses, whereas FRS 19 currently provides an exemption.

(b) Listed investments are currently included at cost less impairment with a note of the market value. FRS 102 requires such investments to be recognised at fair value. In other words FRS 102 requires the unrealised gain to be recognised in the profit and loss account. This gain is not taxable as it is unrealised. Again, FRS 102 requires deferred tax to be provided.

(c) The Cash Flow Statement under FRS 1 deals with balances and movements in cash. FRS 102 deals with cash and cash equivalents;

(d) As noted above, the Statement of changes in equity is a primary statement, whereas the movement on reserves is usually included as a note to the accounts. The SOCE also includes the prior year adjustments that were previously shown at the foot of the STRGL.

Although items (c) and (d) do not directly affect the tax computation, they illustrate that it is important to take care when comparing accounts year by year, pre- and post- adoption of FRS 102.

The statement of changes in equity

This is a new statement introduced by FRS 102.

Prior period adjustments arising from errors and changes in accounting policy are reflected in the Statement of changes in equity which is a new statement introduced by FRS 102. It is ***required*** by entities that are not small, is ***encouraged*** for small entities but not included within FRS 105 for micro-entities.

The SOCIE for the illustration Alastair Ltd from Lecture B928 last month is as follows:

	Share Capital	**Share Premium**	**Retained earnings**	**Total**
Balance at 1 January 2014				
As previously reported	20,000	10,000	180,000	210,000
Previous period adjustment – correction of accounting error			40,000	40,000
Previous period adjustment – change in accounting policy			(64,000)	(64,000)
As adjusted	20,000	10,000	156,000	186,000
Profit for 2014			288,000	288,000
Dividends			(50,000)	(50,000)
Balance at 31 December 2014	20,000	10,000	394,000	424,000
Profit for 2015			320,000	320,000
Dividend			(50,000)	(50,000)
Balance at 31 December 2015	20,000	10,000	664,000	694,000

Note 1

In this example we have included the prior period adjustment relating to the change on accounting policy within the Statement of changes in equity that is how a change in accounting policy would normally be applied under FRS 102. In practice however the changes arising on transition will be adjusted before the presentation in the SOCE and explained in the reconciliation required by FRS 102.

Note 2

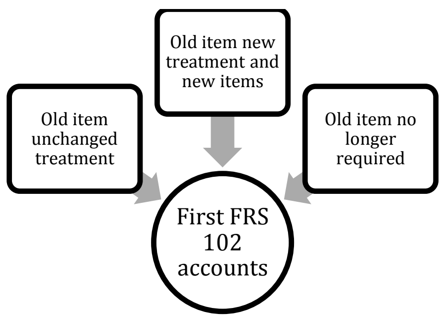
The profit for 2014 has been restated by including the increase in the holiday pay accrual £20,000 net of tax @ 20%. The 2014 accounts included the additional stock write off and therefore there is no adjustment required on transition.

Note that an Inspector of Taxes will find the prior year adjustment line very interesting since it will include only:

(a) Change in accounting policy and the Inspector will want to check whether correct tax law has been applied; and
(b) Corrections of errors and question such as interest and penalties will arise.

Impact on the tax computation

The treatment of items under new UK GAAP can be summarised in the following diagram.



Where new UK GAAP changes accounting profit, either by changing the treatment of an existing item or by introducing a new item, it will be necessary to identify whether:

(a) The changes also changes taxable profit; or
(b) Requires adjustment in the tax computation.

This applies both under income tax and corporation tax.

In addition, where an entity is required to account for taxation, the deferred tax implications of the changes need to be considered.

The tax computation - Profit per the accounts

The following are areas within new UK GAAP with a note of the taxation implications

Accounting profit change	**Tax impact**
Entities to recognise intangible assets separately from goodwill if related to legal or contractual rights.	If allowable for tax, taxable profit follows accounting profit. There is an important transitional exemption that an entity need not restate business combinations before the date of transition. If it restates one it must restate all later years.
Indefinite life no longer permitted for intangibles. If unable to reliably measure useful life of goodwill may not exceed 10 years	Initial 4% election irrevocable, therefore change in useful life does not change allowable amortisation. Otherwise tax follows accounts – assuming allowable for tax
Software should normally be included within intangible assets, although operating systems should be within property, plant and equipment	Depreciation of property, plant and equipment generally not allowable, capital allowances may be available. Software and other intangibles under intangible rules.
Depreciation charges may change as residual value reviewed annually	
Gains on investment property included in profit	Not taxable. Adjust tax computation and provide deferred tax.
Lease incentives spread over term of lease, UITF 28 spread over period to date of rent review	Tax advantageous for lessee, disadvantageous for lessor. Lessees will not wish to take advantage of transitional exemption not to restate incentives where leases entered before the date of transition
Borrowing costs – Accounting policy choice to include in qualifying assets until asset is ready for sale or use. Qualifying assets include property, plant and equipment, intangible assets and inventories	Tax relief on intangible assets and inventories only available when charged to profit and loss i.e. intangible amortised or inventory sold. Tax on property, plant and equipment when borrowing costs incurred.

Biological assets can be included at fair value.	If herd basis adopted for tax, no impact. If using accounts basis, will accelerate accounting and taxable profit. If have previously used cost basis, may elect to spread adjustment income over six years.
Shares (other than in subsidiaries, associates and jointly controlled entities) included at fair value.	Not taxed under loan relationship rules. Capital gains tax payable on disposal. Deferred tax provision required.
Basic financial instruments included at amortised cost	Loan relationship rules apply
Derivative financial instruments included at fair value unless hedge accounting adopted	Loan relationship rule apply. May elect to use disregard regulations. Transitional adjustment may be spread over 10 years.
Contingent fee income recognised earlier?	Will change taxable profit
Sales on deferred terms treated as sales income and finance income over term of finance	Loan relationship rules apply, tax follows accounts.
Holiday pay and other costs of providing benefits recognised earlier	Tax follows accounts if paid within year or nine months afterwards.
Pension deficits on multi-employer scheme recognised when employer and scheme have agreed basis for funding	Tax relief only available when contributions paid.

Income not included in the accounts taxable as trading income

The Regulations confirm that extraordinary items are no longer permitted by company law. They have effectively been prohibited by accounting standards for many years.

The changes to GAAP will not result in any changes in this element of the tax computation which are all adjustments driven by tax legislation e.g. transfer pricing adjustments, balancing allowances.

Income included in the accounts not included as trading income

There potentially are a number of items which may be included here under FRS 102 (but not FRS 105) which were not included previously:

(a) The unrealised surplus on the revaluation of investment property which was previously excluded from profit before tax;
(b) Fair value gains and losses on derivatives and other financial instruments in a non-trading relationship which were not included under old UK GAAP;
(c) Revaluation surpluses on shares. Shares are excluded from the loan relationship rules and are subject to capital gains tax which is not due until the assets are sold.

Deferred tax will need to be provided on each of the above.

Expenses charged in the accounts not allowable against trading income

The principal changes in the tax computation under this heading under FRS 102 (and 105) will arise under S 29 Employment Benefits, where for example provisions for holiday pay, long term benefits etc. which are not payable within nine months after the end of the year are not allowed for tax in the current period.

Also under S 29, more entities will be required to recognise their share of a defined benefit deficit within the profit and loss account. These contributions will not be allowed for tax until paid.

Again, entities will need to consider the deferred tax implications of these adjustments.

Expenses not in the accounts but allowed against trading income

There should not be any changes as a result of changes in GAAP.

Accounting for tax

Where an entity is required to account for tax, e.g. companies, the general principle is that the taxation charged on an item in the accounts, follows the treatment of the accounting item itself. Therefore, if an accounting profit appears in the profit and loss account, so does the tax on that profit irrespective of whether the tax is assessed under corporation tax or capital gains tax or any other type of tax.

This general principle is, of course, complicated by the fact that accounting standards require the inclusion of deferred tax which is defined in FRS 102 as *"Income tax payable (recoverable) in respect of taxable profit (tax loss) for future reporting periods as a result of past transactions or events."* This definition continues the UK approach to deferred tax of dealing with timing differences, and does not follow IAS 12 in the rather more complicated temporary difference approach!!

The treatment of current tax, which is the tax payable of the taxable profit, does not change, although the quantum might depending on changes to accounting profit and whether or not tax law overrides accounting. The big change is in relation to accounting for deferred tax.

There are three impacts on the deferred tax computation:

(a) The exemptions from the requirement to provide deferred tax included in SSAP19 and FRSSE are not included in FRS 102.

    It will therefore be necessary to provide deferred taxation on revaluation surpluses, unremitted overseas earnings, rolled over capital gains and fair value adjustments arising on acquisitions which are currently exempt in many circumstances.

(b) Revised accounting policies produce additional timing differences.

    For example, FRS 102 requires listed investments and other investments in shares where the fair value can be measured reliably to be carried at fair value with gains included in the profit or loss account.

    This means recognising an accounting profit where fair value exceeds cost. Unless the investments are held for trading, and taxable on being marked to market, tax would not be payable on the revaluation surplus as it is not a trading profit. However the surplus is a timing difference and deferred tax needs to be provided – and reviewed and amended where necessary on an annual basis.

    Currently, such investments would usually be carried at the lower of cost and net realisable value if current assets, or cost less impairment if fixed assets.

(c) Deferred tax provisions may also change as the current practice of discounting the provision, permitted by FRS 19, is not allowed under FRS 102.

Practice differs as to whether deferred taxation is computed by the tax department (if one exists) or within the accounts or audit team, but tax practitioners should be alert to these changes for review purposes.

FRS 105

One of the simplifications is that FRS 105 exempts micro-companies from the requirement to provide deferred tax. Note that this has two impacts. Not only is a micro-company not required to include deferred tax on the new timing differences or those where the exemptions have been removed but it will be able to exclude those timing differences such as accelerated capital allowances currently included.

This will be done by restating the opening balance sheet at the date of transition to FRS 102 by debiting provision for retained tax and crediting reserves. It will have the effect of increasing distributable reserves, and there is a danger that companies may not have sufficient reserves to cover the tax liability which eventually crystallises.

The tax reconciliation

There are a number of disclosure differences between FRS 102 and current GAAP:

(a) FRS 19 requires a reconciliation of the current tax charge or credit reported in the profit and loss account to profit before tax multiplied by the applicable tax rate, whereas FRS 102 requires a reconciliation of the total tax expense or income for the period (as included in profit or loss).
(b) FRS 102 requires an analysis of the major components of the aggregate tax charge/credit recognised in the financial statements to be given whereas FRS 16 and FRS 19 require this analysis to be given separately for tax recognised in profit or loss and other comprehensive income.
(c) FRS 102 does not require disclosure of movements in deferred tax balances in the period or of unrecognised deferred tax amounts which are required by FRS 19.
(d) FRS 102 requires disclosure of the net reversal of deferred tax expected to occur in the period following the reporting period. This is not required under FRS 19.
(e) FRS 102 requires disclosure of the tax expense relating to discontinued operations but FRS 16 does not.

Contributed by Bill Telford

FRS 102 – Software costs and other intangibles (Lecture B932 – 8.12 minutes)

Restatement of capitalised software

Old UK GAAP treated software costs as tangible fixed assets. For tax purposes, the expenditure was treated as plant and machinery and capital allowances were claimed.

FRS 102 requires the restatement of this software as an intangible asset.

Part 8 CTA 2009 prescribes the tax treatment of intangible assets for companies and, generally, the tax treatment follows the accounting treatment, but there are exceptions.

Software on which capital allowances have been claimed will not fall within Part 8 CTA 2009 (s.804). On restatement of software from tangible to intangible asset there will be no tax adjustment, but the subsequent amortisation will be disallowed

Software purchased in the year of adoption and subsequently will follow the general rule unless the company makes an election under s.815 CTA 2009.

This permits the company to claim capital allowances as a tax deduction instead of the accounting expense for amortisation and impairment.

It will beneficial to make the election if AIA is available or if the amortisation rate would be less than 18% per annum, reducing balance basis.

If the company does not elect for capital allowance treatment on software after adopting FRS 102 there is the potential for errors in its Corporation Tax Returns.

It will need to disallow the amortisation of the old software on which it has claimed / is claiming capital allowances but allow the amortisation on the software purchased since FRS 102 adoption

Unless there is a detailed analysis of the software costs the company could mistakenly add back all its software amortisation or fails to claim it all in error.

Goodwill and other customer-related intangibles

Finance Act 2015 prevents a deduction for goodwill and customer-related intangible assets purchased from a <u>connected person</u> from 3 December 2014

Finance (No.2) Act 2015 prevents similar deduction for goodwill and customer-related intangible assets purchased from <u>anyone</u> from 8 July 2015

Goodwill and customer-related intangibles purchased before these dates can continue to qualify for amortisation and impairment deduction

Research and development costs

Research and development costs of a revenue nature will continue to qualify for deduction when incurred irrespective of the accounting treatment (FRS 102 permits the capitalisation of development costs when certain criteria have been met).

Qualifying R&D costs will also be eligible for the 130% enhancement under the SME scheme. If this creates a loss it can potentially be cashed in for a 14.5% repayable tax credit

30% enhancement or 11% R&D Expenditure is available under the Large Company scheme. This would apply to a small company it a large company subcontracts R&D work to it

Since November 2015, HMRC is offering smaller companies an advanced assurance scheme for R&D enhancement. If the company receives assurance its R&D enhancement claims will be assured for the next four years.

Contributed by Malcolm Greenbaum

FRS 102 and non-market loans **(Lecture B933 – 15.52 minutes)**

Introduction

FRS 102 requires that loans that are made below market interest rate must be initially recorded at the present value of the repayments, discounted at a market rate

The general tax law on loan relationships for companies is that debits and credits are deducted and taxed when booked to:

- profit and loss account,
- other comprehensive income, or
- directly to shareholders' funds

Example 1

A non-controlling shareholder lends £100,000 to B Ltd, a UK company, on 1 January 2015.

The loan is interest free and is repayable on 1 January 2016.

It is assessed the market rate at which B Ltd can borrow is 10% per annum.

Accounting treatment:

Initial recognition:

Dr Cash (balance sheet)	£100,000	
Cr Loan liability (balance sheet)		£90,909
Cr Capital contribution (Equity)		£9,091

Effective interest accrual:

Dr Finance expense (P&L)	*£9,091*	
Cr Loan liability (balance sheet)		*£9,091*

Tax treatment

The credit of £9,091 to equity would be taxable in the period when the loan is granted.

The finance expense is deductible in the accounting period in which it is recognised.

For loans redeemed in the same accounting period, the two amounts would offset.

For longer term loans, the credit is taxed while relief for the debits (finance costs) will be spread over the loan term.

Transition to FRS 102

Where, on transition, there is a reduction in the carrying value of the liability of the company (e.g. because of discounting a non-market interest loan to present value), this results in a taxable credit being brought into account (s.316 CTA 2009).

If the loan falls to be repaid after the end of period when FRS 102 is adopted, the credit will be brought into account for tax purposes over 10 years under the 'Change of Accounting Practice' regulations.

Example 2

A non-controlling shareholder lends £100,000 to B Ltd, a UK company, on 1 January 2014. The loan is interest free and is repayable on 1 January 2019

It is assessed the market rate at which the company can borrow is 10% per annum.

<u>Accounting treatment:</u>

Year ended 31 December 2014 (old GAAP)

Dr Cash (balance sheet)	£100,000	
Cr Loan liability (balance sheet)		£100,000

No amounts are recognised in profit or loss in the accounts (nor OCI, nor equity)

No amounts are therefore brought into account for tax purposes

Restatement on transition to FRS 102 on 1 January 2015

Dr Loan liability (balance sheet)	£31,699	
Cr Retained earnings (equity)		£31,699

The restated value of the loan liability is £68,301 (£100,000 ÷ 1.10^4)

Year ended 31 December 2015

Dr Finance costs (10% x £68,301)	£6,830	
Cr Loan liability		£6,830

<u>Tax treatment:</u>

A transitional credit of £31,699 will be brought into account by B Ltd over 10 years, i.e. £3,170 each year.

In 2015, B Ltd will bring into account a net debit of £3,660 (finance expense of £6,830 debit, minus transitional credit of £3,170).

Over the course of the loan term the loan will accrete to its maturity value so B Ltd will bring into account the same amount of debits (the total finance expense recognised) and credits (the amount recognised initially in reserves), because there is no overall profit or loss from the loan relationship.

Connected party loans

If a company lends to, or borrows from, a connected person, the tax law prescribes that the loan is initially booked at cost (i.e. the amount lent or borrowed (s.349 CTA 2009)). This is even if lent at below market interest rate.

If the redemption amount is different to this, the cost is amortised to the redemption amount over the loan term.

So the loan is not discounted for tax purposes and there is a difference between the accounting and tax treatments.

Example 3

In 2010, a parent company (P) lent £100,000 to its UK subsidiary (S) on interest free terms with the debt repayable in 10 years' time.

Under Old UK GAAP the companies simply hold the loan at its original transaction price of £100,000 (i.e. 'cost').

In 2015 the subsidiary adopts FRS 102.

The carrying value of the loan is restated to be £80,000 on the basis that the loan should have been measured on initial recognition at its fair value / present value at that time

The loan will then be accreted back up to £100,000 over the term of the instrument, with corresponding amounts recognised in P&L as expense

Tax treatment:

S.349 CTA 2009 requires connected company loans to be recognised at amortised cost for tax purposes. S will not bring into account any amounts on transition to FRS 102 nor thereafter.

The initial credit to equity of £20,000 is ignored.

The accretion of finance costs to amortise the liability to £100,000 is disallowed each period.

If P and S were not connected, S would recognise the transitional credit of £20,000 over 10 years and bring into account the annual accretion of finance costs (also totalling £20,000) over the remaining loan term.

Contributed by Malcolm Greenbaum

VAT

What was the status of repairs?

Summary – The Tribunal dismissed the appeal to reject claims for input tax relating to repair expenses in a clubhouse

A golf club claimed input tax on the repair costs to a lift at the clubhouse, new curtains for the bar and lounge area and refurbishment of bar furniture. The taxpayer claimed that all items of expenditure were wholly linked to the taxable supplies of food and drink.

HMRC ruled that the costs were also linked to exempt supplies of golf club membership because the bar was "part and parcel of the running and benefit of the club as a whole".

The taxpayer appealed.

Decision:

The First-tier Tribunal agreed with HMRC. The judge said the use of the clubhouse was an intrinsic part of membership. It could not be said that the bar and lounge area was used exclusively for the sales of refreshments. It was "at least in part a meeting place for golfers to manage, co-ordinate and enhance their golfing activities". From an economic perspective, the area was "an incidence of membership of the golf club as well as a place to buy food and drink".

The tribunal added that the bar facilities were "part of an overall supply of exempt golf club membership, the consideration for which is the membership subscription".

The taxpayer's appeal was dismissed.

Comments – From an economic perspective the exempt and taxable supplies were interlinked and fed from each other> This type of case is fact- sensitive.

Bedale Golf Club Ltd v HMRC TC4619

Option to tax disapplication

Summary – The Tribunal dismissed the appeal against HMRC's decision to assess output tax in respect of a sale of an Opted property in the UK to a charity

The charity bought a property with an option to tax election but it certified to the seller that the option should be overridden because the building was to be used for a relevant charitable purpose.

HMRC disputed the validity of the certificate on the basis that two-thirds of the property was rented to independent tenants for exempt rent and that educational studies carried out in the rest of it were made in return for fees. It was to be used in effect for business purposes and VAT should have been charged on the property sale.

The charity argued that the temporary letting of rooms was linked to its charitable activities and was not intended to be a source of business income.

The money would be used to off set the institute's overheads; in this way, the trustees were complying with their obligations to minimise costs. The teaching

Decision:

The First-tier Tribunal considered the business tests in *CCE v Lord Fisher* [1981] STC 238. It said the absence of a business profit could not be the definitive factor in deciding the nature of a business's activities.

On the fees received for teaching, although these may have been lower than they may have been for the institute to have made a profit, they were a significant amount. They could only be regarded as consideration for teaching. Similarly, the lettings had to be treated as a business activity — the rooms were let to third parties not connected to the charity's activities.

The tribunal concluded that the supplies made by the charity from the property had a business nature, so the building sale should have been standard rated.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, noted: “The option to tax regulations allow the disapplication to apply to part of a building that is used specifically for charitable purposes by a charity. So, if all charitable activities are focused on, say, one floor of a four-floor building, 25% of the property sale could be VAT exempt. This case also highlights the principle that income can still be of a business nature even if it does not make an overall profit.”

The Trustees of the Institute for Orthodox Christian Studies v HMRC TC4622

Different use for building

Summary – The UT dismissed the appeal from the FTT decision that zero-rating did not apply to the construction of a pavilion that comprises mainly changing room facilities and an equipment storage area

A charitable community association owned a village hall and sports pitch on which there was a changing hut. In 2013 work began on replacing the hut with a pavilion that would include changing facilities. The association applied for zero rating on the building but HMRC refused. The First-tier Tribunal upheld HMRC's decision, and the appeal proceeded to the Upper Tribunal.

Decision:

Lord Tyre in the Upper Tribunal noted that the First-tier Tribunal had decided the facilities were provided for the local community which owned, organised and administered them. It had, however, decided that the building could not be said to have a similar use to that of a village hall, except insofar as the meeting room/kitchen could be used by the community for recreational or social purposes.

After referring to several cases, including *Ormiston Charitable Trust* (13187), *Jubilee Hall Recreation Centre Ltd v CCE* [1999] STC 381, and *Caithness Rugby Football Club* (TC4560), the judge said the analysis should focus on whether the use of a building was similar to a village hall, rather than whether the building itself was similar to a village hall. It was essential that the activities were carried out in the building and this created a difficulty for the association because the building was used more as an adjunct to the social or recreational facilities provided by the sports pitch.

The First-tier Tribunal had focused correctly on the potential use of the building rather than its facilitation of the use of the sports pitch. It was entitled to conclude that the main purpose of the building was to provide changing facilities and storage, and was not used in a similar way to a village hall.

The taxpayer's appeal was dismissed.

Comments – Many Tribunal decisions in this area are distinguishable on their facts.

New Deer Community Association v CRC, Upper Tribunal

No exemption for United Grand Lodge

Summary – The Tribunal found that the aims of UGLE were not of a philosophical, philanthropic or civic nature and therefore the supplies made to its members in return for their subscriptions were not exempt from VAT

The United Grand Lodge of England claimed that its aims had a philosophical, philanthropic or civic nature and therefore the supplies made to its members in return for their subscriptions were exempt from VAT under article 132(1)(l) of the Principal VAT Directive.

HMRC disagreed. The First-tier Tribunal dismissed the taxpayer's appeal.

Decision:

The Upper Tribunal said the First-tier Tribunal had found that the organisation had five aims and had gone on to test the extent to which they fell within the exemption. The judge said this had been the correct approach and the tribunal had been entitled to find the promotion of freemasonry broke down into a series of aims or objects.

The judge agreed with the First-tier Tribunal that, given that about 75% was directed to masons or their dependants, not all of the taxpayer's charitable giving could be considered philanthropic.

Further, the judge found that only a small part of the taxpayer's aims were of a civic nature. The exhortation to carry out good deeds and be a good citizen were "not enough to colour the entirety of the activities".

The Upper Tribunal ruled that the aims of freemasonry did not fall within the exemption and dismissed the taxpayer's appeal.

Comments – The burden of proof was on UGLE to demonstrate that it had qualifying aims and that they were UGLE's main aims. They did not do so. It is possible to have multiple objects – no single one of which can be predominant.

United Grand Lodge of England v CRC, Upper Tribunal

Overseas expenses not allowable

Summary – The FTT dismissed the appeal against an assessment for sums wrongly claimed on a UK VAT return

For many years, the sole director of Ppig believed that he could claim on his UK VAT return VAT paid on business expenses incurred in other EU countries where he worked as a mechanical engineer. In fact, only VAT incurred on UK expenses qualifies as input tax on a UK VAT return. After a VAT compliance visit by HMRC, the officer raised an assessment for £67,168 plus interest for the quarterly tax periods from March 2010 to June 2013 and explained to him that he should have claimed the VAT on his overseas expenses through the EU refund system.

However, under that system claims must be made within nine months of the end of a calendar year — any later claims are time barred. As a result, the taxpayer was time-barred for the three years from 2010 to 2012.

Decision:

The First-tier Tribunal expressed sympathy for the taxpayer. The judge said the company would not have been out of pocket had the director known the correct rules earlier. He said it was clear the appeal had to be dismissed, but he encouraged HMRC to give the company time to pay the remaining sums outstanding. The company had a good compliance record and it was unfortunate that an innocent error had resulted in "severe financial consequences".

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, noted: "Even though the taxpayer had no chance of winning this case, the appeal led to HMRC reducing their original assessment by £3,817 to £63,351 because, by the time the officer raised the assessment, the errors identified in the March 2010 return were time-barred under the four-year rule. The case shows how VAT can catch out even the most simple business operations and why it is important that external accountants always do a general review of VAT issues when they are completing year-end accounts for a client."

Ppig Ltd v HMRC TC4665

Sale of a machine

Summary – The FTT said there had been a transfer in ownership of the machine from the company to the customer that amounted to a supply of goods.

The company was sued by a customer in relation to a diamond-cutting contract. Under the settlement the taxpayer paid compensation and transferred a particular machine to the customer that was relevant for the process.

The taxpayer did not account for output tax on the value of the machine on the basis that it was outside the scope of VAT because it formed part of the compensation payment.

The taxpayer appealed.

Decision:

The First-tier Tribunal said there had been a transfer in ownership of the machine from the company to the customer that amounted to a supply of goods.

The consideration was the customer's agreement not to pursue its claim for damages. The judge said the nature of the consideration made no difference. The taxpayer was required to account for output tax on the sale of the machine.

The taxpayer's appeal was dismissed.

Comments – The decision is self-explanatory.

Phoenix Optical Technologies Ltd v HMRC TC4631

Further to go with DPAS

Summary – The UT allowed HMRC's appeal and stayed proceedings in respect of the patients who signed the DPAS form pending the final decision in the ECJ in Bookit Ltd

The taxpayer, DPAS, designed and implemented dental plans under which the private patients of dentists who were registered with DPAS could spread the cost of basic dental healthcare throughout the year.

The plans administered by the taxpayer were branded in the name of the dentists' practices. Each month, the taxpayer accounted to the dentists for the aggregate amount payable to them for all of their patients who had paid the monthly fee less a sum retained by DPAS as a charge for its services. The taxpayer managed the administration, finance and insurance side of the dental plans.

HMRC accepted that DPAS made exempt supplies of "transactions concerning ... payments, transfers" within the Principal VAT Directive.

In 2008, the taxpayer introduced a £10 registration fee to recover the cost of registering a patient on a dental plan directly from the patient.

In October 2010, the Court of Justice of the EU in *CRC v AXA UK plc (C-175/09)* [2010] STC 2825 ruled that Denplan supplied debt collection and factoring services because the aim was to obtain payment of debts due to its clients, namely the dentists. As a result, those services were excluded from the VAT exemption.

In July 2011, HMRC said businesses could delay implementing the AXA decision until 1 January 2012. In the interim, the taxpayer restructured its arrangements so that, from 1 January, it would make supplies of services to the patients as well as to the dentists. This was on the basis that the supplies to patients would be exempt from VAT.

HMRC ruled that supplies of services for the administration of dental plans made by the taxpayer from 1 January 2012 were either a single, standard-rated supply of services to the dentists or a mix of standard-rated supplies of services to patients.

The First-tier Tribunal allowed the taxpayer's appeal.

HMRC appealed.

Decision:

The Upper Tribunal said there was an agreement between DPAS and patients who signed the acceptance form. Under that, DPAS supplied services in return for monthly charges paid by the patients as part of their monthly payments under their dental plans. As a result, under the contractual arrangements introduced from 1 January 2012 and "as a matter of economic and commercial reality", DPAS made a supply of services to those patients. HMRC's appeal in that respect was dismissed.

However, there was no agreement where the existing patients had not signed and returned the taxpayer's acceptance form. In such cases, the taxpayer did not supply services to patients. The First-tier Tribunal, in finding that the taxpayer had supplied services to such patients, had made an error of law, and HMRC's appeal on that was allowed

On the VAT liability of the supplies made by the taxpayer to the patients, the tribunal reserved judgment in anticipation of the CJEU's decision in *Bookit Ltd* (TC3972) and *National Exhibition Centre Ltd v CRC* [2015] STC 1185.

The Upper Tribunal said the supply by DPAS in return for the £10 registration fee was separate from the supplies of services made in return for the charges retained from the patients' monthly payments and was chargeable to VAT at the standard rate. The judges allowed HMRC's appeal on this issue.

Finally, the tribunal found that the transactions could not be regarded as artificial and dismissed HMRC's appeal on this.

Comments – This decision does not represent the end of the road for for DPAS or for HMRC. The UT has directed that both parties should submit written representations on the consequences and application of the ECJ's decision in BOokit and NEC on the issue of the VAT liability of the supplies made by DPAS to the patients who agreed to the new contractual terms after the beginning of 2012.

DPAS Ltd v CRC, Upper Tribunal

R&C Brief 22/2015 - changes following Le Credit Lyonnais (C-388/11)

Background

In Le Credit Lyonnais the CJEU found that the VAT Directive could not be interpreted so as to allow a company to take into account the turnover of its foreign branches when calculating how much input tax it can deduct in the member state where it has its principal establishment, using a 'single pot' calculation. It also found that a sector in a partial exemption method could not be based on a geographic location.

To reflect that decision, the March 2015 Budget announced our plans to exclude supplies made by overseas branches from partial exemption methods. As a result of feedback on the subsequent consultation, we have narrowed the scope of changes to those set out below.

We exposed draft regulations to implement the necessary changes for a limited consultation in October 2015. We have revised the draft regulations in response to comments received.

Changes to the VAT Regulations 1995

Regulation 101 will be amended to make it clear that the value of supplies made from establishments outside the UK cannot be taken into account by businesses using the standard method.

Regulation 102(1A) will be amended to make it clear that:

- where a sectorised method is used, each sector within it must reflect the use to which VAT-bearing costs are put in the business and in that sector, the structure of the business and the type of activity undertaken by that sector
- the value of supplies made from establishments outside the UK can only be taken into account in a sectorised method

Changes will be made to Regulation 103 to mirror the changes to Regulation 102.

Operative date of the changes

Changes to Regulation 101 will have effect in relation to any 'standard method' longer period beginning on, or after, 1 January 2016.

Changes to Regulation 102 will have effect in relation to any methods approved or directed by HM Revenue and Customs (HMRC) on, or after, 1 January 2016.

Changes to Regulation 103 will have effect in relation to VAT prescribed accounting periods beginning on, or after, 1 January 2016.

Regulation 101 (standard method)

The value of supplies made by overseas establishments will be excluded from the standard method.

Businesses that make supplies from overseas establishments and currently use the standard method will no longer be able to recover related input tax on the basis of 'use' under Regulation 101 and a number of options will apply, as follows:

- where such a business continues to use the 'standard method' it will need to apply the UK recovery rate when recovering input tax used to make supplies from overseas establishments
- where such a business continues to use the standard method, and the difference between the result of using that method and using a method which fairly reflects the use of the tax bearing costs exceeds £50,000 (or £25,000 in the case of group undertakings), it will need to account for the difference because of the effect of the standard method override set out in Regulations 107A - 107F
- such a business can apply to use a special method
- where such a business continues to use the standard method and there is a material difference between the result of using that method and using a method which reflects the extent input tax is used in support of overseas supplies (whether a difference is material will depend on the circumstances of the particular business, such as the amount of VAT incurred and the difference in VAT recoverable), we will expect that business to apply to use a special method pursuant to Regulation 102 even if the standard method override is not engaged. In the absence of such an application we may direct the use of a special method

Regulation 102 (special methods)

Methods that are not based on sectors cannot include the value of supplies made from overseas establishments. For partial exemption special methods, a business may only have a method based on sectors where each sector within it reflects the use made of goods and services in the business and in that sector, the structure of the business and the type of activity undertaken by that sector

Regulation 103 (foreign and specified supplies)

Where a business has a special method that does not attribute input tax in respect of the foreign and specified supplies it makes, it will need to reflect the changes to Regulation 103 in prescribed accounting periods beginning on or after 1 January 2016.

Calculations that are not based on sectors cannot include the value of supplies made from overseas establishments

For Regulation 103 a business may only have a calculation based on sectors where each sector that it is based on reflects the use made of goods and services in the business and in that sector, the structure of the business and the type of activity undertaken by that sector

R&C Brief 23/2015 – VAT Grouping rules and the Skandia judgement

Background

Details of the Skandia America Corporation decision can be found in Revenue and Customs Brief 2 (2015): VAT grouping rules and the Skandia judgment. This outlines the VAT treatment that applied before the Skandia decision, how VAT treatment will change as a result of the judgment and the date when the change will take effect.

Revenue and Customs Brief 18 (2015) was published on 30 October 2015. It confirmed UK VAT changes resulting from the Skandia judgement and provided details of which other member states operate ‘establishment only’ VAT grouping.

Further information on other member states’ VAT grouping

HMRC has received additional information about VAT grouping in the Netherlands and Spain. The table provides an updated view on how the UK expects member states to operate VAT grouping in the light of the Skandia decision, and makes minor clarifications.

Member state	Latest position
Cyprus, Finland, Germany, Spain (advanced method)	At the time of publication the intention of these member states is uncertain
Austria, Ireland, the Netherlands,	HMRC does not expect these member states to apply ‘establishment only’ VAT grouping to create intra-establishment supplies when the

Member state	Latest position
UK	establishment in the member state is VAT grouped
Italy, Romania, Spain (basic method)	These types of 'VAT grouping' are purely administrative, treating each member as a separate taxable person and just amalgamating their VAT figures on a single return. Such 'grouping' does not trigger the UK VAT changes
Belgium, the Czech Republic, Denmark, Estonia, Hungary, Latvia, Slovakia, Sweden	HMRC expects these member states to apply 'establishment only' VAT grouping to create intra-establishment supplies when the establishment in the member state is VAT grouped
Bulgaria, Croatia, France, Greece, Lithuania, Luxembourg, Malta, Poland, Portugal, Slovenia	HMRC understands these member states do not have VAT grouping

It must be noted that:

- this information is provided as a guide only
- it is the responsibility of individual businesses to confirm the situation with the relevant member state tax authority and agree how it applies to their own particular circumstances
- HMRC expects individual businesses to apply the changes contained within this brief from 1 January 2016 (where the member state tax authority has applied establishment only VAT grouping to create intra-establishment supplies when the establishment in the member state is VAT grouped)
- where the position is currently uncertain, HMRC expects the individual business to apply the changes contained within Revenue and Customs Brief 18 (2015) from the date upon which the member state tax authority applies such establishment only VAT Grouping, if this is after 1 January 2016

Expense or disbursement? (Lecture B934 – 11.59 minutes)

Introduction

What is the difference between an expense recharged to a client and a disbursement? It sounds a simple question but as far as VAT is concerned, the answer is……a lot! I'll share some twists and tales on this very important subject.

Recent case – MoT certificates

The recent case of second hand car dealer *Richard L Finney* (TC4667) considered whether the cost of MoT certificates in relation to car sales should be excluded from the business' second hand margin scheme calculations. In other words, was the charge of £37 to the customer (the cost of an MoT certificate at the time of the dispute) a disbursement that was outside the scope of VAT or part of the actual vehicle sale and therefore subject to output tax on this part of the margin?

The taxpayer took the view that if he did a deal with a customer, whereby he agreed to obtain a fresh MoT certificate before the sale (perhaps because the existing certificate only had eight months or less to run) the margin should be reduced for VAT purposes by the cost of the certificate. In other words, £37 of the sale proceeds was treated as a disbursement for VAT purposes. HMRC felt this was incorrect because the supply represented the sale of a car with an MoT certificate included ie a single rather than multiple supply. The tribunal agreed with HMRC and dismissed the taxpayer's appeal.

As a general principle, there would be no problem treating the MoT charge to the customer as a disbursement if the customer's request for a fresh certificate had come after the sale had taken place ie as an extra sale separate to the main supply of the car. The additional payment could then have qualified as a disbursement and been excluded from the margin scheme calculations.

HMRC guidance

I dealt with a query from a management consultant a couple of years ago about whether the travel expenses he recharges to his clients (eg for rail fares, air fares, taxi fares or mileage expenses) should be treated as a disbursement with no VAT charged or should always be standard rated. The answer is neither….the rule is that the travel expenses follow the same VAT liability as the work being performed. So if the consultant is providing his services to an overseas business customer, where the main service is outside the scope of VAT under the general B2B rule (the place of supply being the customer's country), then the travel expenses will also be outside the scope. But if the consultant is providing his services to a UK customer (or non-business customer in the EU), then his fee will be standard rated and so will the expenses.

So why are travel expenses not classed as a disbursement, even though the management consultant in my example might show the word 'disbursement' on his sales invoices? The answer is because in the case of a 'disbursement', a middle business is picking up a bill that actually belongs to his customer. In the case of travel expenses, the supply of eg rail travel is between the rail company and the consultant.

Contrast this situation with that of a solicitor acting for a house buyer, and the solicitor pays out expenses such as land registry fees, Stamp Duty Land Tax and local authority search fees on behalf of the client. These charges qualify as disbursements because the expenses belong to the final client and not the solicitor.

To give a supporting reference on the above analysis, the following Box 1 gives HMRC's interpretation of the rules.

Box 1 – HMRC VAT Notice 700, section 25

25.1 – Disbursements for VAT purposes

It is the practice in some trades and professions for some or all of the costs incidental to a supply, such as travelling expenses, to be described as disbursements and shown or charged separately on the invoice issued to the client. In many cases, these items do not qualify to be treated as disbursements for VAT purposes. If these costs have been incurred by suppliers in the course of making their own supply to their clients, they must be included in the value of those supplies where VAT is calculated.

Conditions for disbursements

Going back to the example of the solicitor acting for a house buyer, the solicitor needs to be on the ball as far as his procedures are concerned to ensure there is no hidden VAT problem in relation to the disbursements he charges to his client:

- He must ensure that all of the costs in question belong to the house buyer, rather than his own business. So recharges to the client for his telephone and photocopying expenses would not qualify as disbursements – these expenses are his own overheads and are dealt with in the same way as the travel expenses.
- He must have acted as an agent for the house buyer when he paid the various third parties eg local authorities, land registry office etc.
- The house buyer must have received and used the goods or services provided by the third parties.
- The house buyer was responsible for paying the third parties and he or she authorised the payments to be made.
- The various payments must be itemised separately on the solicitor's invoice(s) and he will only recover the exact amount paid to the third parties ie he will not apply a mark-up to the costs in question.

Note – the above bullet points are adapted from the general rules for disbursements listed in HMRC VAT Notice 700, para 25.1.

Insurance charges

In the recent case of *Wheels Private Hire Ltd* (TC4547), the court had to consider whether a charge to self-employed taxi drivers by a taxi control company represented a supply of exempt insurance or part of a single charge for an insured vehicle ie standard rated.

Although this particular issue is more of a 'single or mixed supply' challenge rather than 'disbursement or expense' dilemma, it shows the importance of suppliers identifying the nature of their supplies as far as VAT is concerned. And to add an extra twist to the tale, HMRC lost this case in the First-tier Tribunal but have appealed the decision to the Upper Tribunal. So what are the key facts?

- Wheels Private Hire Ltd (WPH) provides a radio facility to over 200 taxi drivers and for 74 of the drivers, they also hire a car to the self-employed driver. A charge of £120 per week is made to these 74 drivers, to include the car and radio facilities, and a further £45 per week is charged if the drivers also want to take out third party liability cover through the company.

- WPH argued that the latter fee was exempt from VAT as an insurance charge – linked to a block cover policy taken out with an insurance company. HMRC claimed it was standard rated as a single supply of a car with radio service. The tax involved was £66,859 and most of the drivers were not VAT registered so unable to claim input tax.

HMRC's main argument seemed to be that the company was "not an insurer or an intermediary" and therefore the charges it made to drivers could not be 'insurance'. They added that a driver taking a fleet vehicle was already pre-insured so there could be no added value with the extra charge.

The court recognised that even though the drivers were not recognised by name in the insurance policy between the insurance company and WPH, there was a link with the drivers through their vehicle registration number, and it was inconceivable that the driver would not get the benefit of the cover if he was being sued for a liability claim by a customer. To quote from the tribunal report:

"It is in our view a separate and independent supply, optional from the viewpoint of the driver, and separate from the supply of the vehicle and the supporting radio service. Whether the driver obtained his own independent insurance cover or not, the supplies of the vehicle and the radio service could be enjoyed similarly."

The key thing in this case (which is why I think the decision was correct) is that the driver has the option of paying for the insurance cover or otherwise – this is very different to the situation where a business agrees a price for goods or services with a customer, and then describes part of the agreed price as insurance in order to save some VAT. The best advice with any insurance scenario is to get the full facts of the arrangement (contracts, pricing etc) and then review the circumstances with the help of HMRC's VAT Notice 701/36.

Hotel expenses challenge

Here is a very common question that I have been asked over the years:

- The management consultant in our earlier example stayed at the Hilton Hotel and paid £120 + VAT to the hotel for his bed and breakfast accommodation. His client has agreed to cover this cost – should the consultant invoice the client for £120 + VAT or £144 + VAT?

The answer is…..it's up to the consultant. It's not a VAT problem. As long as HMRC get 20% VAT on the amount charged to the client, they will be happy. In reality, the consultant will be making a £24 profit on the accommodation if he charges £144 + VAT, which might not be playing the game with a straight bat, unless he uses the flat rate scheme which blocks input tax claims. For scheme users, a charge of £144 + VAT could be commercially justified, although VAT enthusiasts might argue that he would still be winning because the flat rate percentages (14.5% for a management consultant) adjust for the loss of input tax suffered by scheme users.

Contributed by Neil Warren

Medical services……exempt or standard rated? (Lecture B935 – 11.51 minutes)

Introduction

The name Peter d'Ambrumenil will be familiar to many VAT enthusiasts. His landmark case was heard in the ECJ over ten years ago (case ref: C-307/01) and the issues are to some extent still rumbling around and causing confusion to both HMRC and the medical world.

Mr d'Ambrumenil felt that his work writing medical reports in relation to insurance claims should be standard rated rather than exempt. HMRC said it was exempt because he was a qualified medical practitioner (a doctor) and the service utilised his medical expertise. So why would the taxpayer be keen to charge VAT on his services whereas HMRC were happy for the services to qualify for exemption under VATA1994, Sch 9, Group 7 (Health and Welfare)? The answer is because his customers were presumably able to recover input tax, so his VAT charge was not a problem. He won the case because the Court decided that exemption only applies under EU law if a medical service meets two key conditions:

- It is carried out by a qualified medical practitioner who is enrolled or registered on the appropriate statutory register – so no issue here for Mr d'Ambrumenil
- The purpose of the service is to protect, maintain or restore the health of the person concerned ie excluding non-health related services such as assessing a person's injuries in relation to insurance claims.

Note – the 'purpose' test established by this case was incorporated into UK law on 1 May 2007. HMRC's guidance and interpretation of the legislation is published in VAT Notice 701/57, Health professionals and pharmaceutical products.

If you have clients in the medical sector, this notice is worth a read – it is very clear and well written.

Practical examples

Which one of the following medical services will not qualify for VAT exemption?

A - The services of an acupuncturist to help a patient's back pain.

B – The services of a hygienist at a dental practice – making a client's teeth nice and shiny for his forthcoming wedding

C – A doctor performing a hip replacement operation

D – The services of a psychiatrist assessing the medical condition of children from deprived families to help them become more confident dealing with daily life

The answer is 'A' – there is no statutory register for acupuncturists. In the case of 'B' – although the groom was using the hygienist services for a non-medical outcome, the process of teeth cleaning and hygiene work still has a clear medical purpose and is therefore exempt from VAT.

Supply of staff or medical services?

Here is the crux of a more fundamental issue. If a doctor is providing his personal services through eg a limited company to a hospital, are these services provided by the company exempt from VAT as a medical service or standard rated as a supply of staff?

The main reason why there is a lot of money at stake with this particular topic is because most 'customers' who receive medical services from medical experts are unable to claim input tax, either because they are making exempt medical supplies themselves (eg BUPA hospitals) or because they are a public body unable to reclaim VAT on their expenditure through the budgeting system.

The reason why there has been a lot of recent interest in this topic (and also a lot of concerned advisers acting for eg locum doctors) is because of a recent VAT case that muddied the waters a bit, unfortunately it was a case won by HMRC. In the case of *Rapid Sequence Ltd* (TC2826), the key question was whether supplies of locum doctors by an employment agency were VAT exempt as relevant to medical services or standard rated as a supply of staff ie the exact scenario I raised in my opening paragraph.

In the Rapid Sequence case, the company supplied overseas locum anaesthetists to NHS hospitals in the UK and treated the supplies as exempt from VAT on the basis that medical services were being carried out by a qualified medical practitioner, with a view to treating patients (ie medical care). HMRC's view (and supported by the tribunal) was that Rapid Sequence was making a supply of staff rather than medical services, and the fees were standard rated.

Note – the structure of the arrangement was that the locum would invoice Rapid Sequence for ‘x’ hours of time at an agreed hourly rate; Rapid Sequence would then apply a mark-up to this rate and charge the NHS hospitals. The difference between the hourly rate charged and paid was effectively its gross profit.

A key point in the tribunal’s analysis was that the doctors were instructed by the hospitals as to the nature of their duties, rather than the doctors acting under their own instruction to perform a specific medical function eg a heart operation. To quote from the report:

“The doctor provided by Rapid Sequence, whilst exercising his own judgment as to how to perform his services does so in the hospital under the direction and control of the relevant NHS administrators or medical staff. As far as the patient is concerned, he is receiving services from a doctor working under the supervision of the NHS Trust, not Rapid Sequence. Rapid Sequence plays no part in deciding how the doctor concerned provides his services.”

This case reaffirms the view of HMRC that the services of a health professional supplied to a medical institution by an employment agency are standard rated, even if the person is providing medical services to patients, with a view to improving the health of the individuals in question. Rapid Sequence was deemed to be making a supply of standard rated staff.

A key phrase in the Rapid Sequence case was ‘employment agency’ – so does this mean that a one person company (same person as director and 100% shareholder) where the ‘person’ is a qualified medical practitioner is not affected by the case because he is not making a mark-up on the services of other people, only providing his own expertise? HMRC have apparently said that they do not consider the case has implications for one person companies, and merely clarifies their own policy about the supplies of medical experts via an employment agency.

HMRC guidance

I think the key section in the HMRC guidance is para 6.7 of Notice 701/57 – which I have fully reproduced below, and which seems to be consistent with the Rapid Sequence case. In other words, it needs to be considered whether the supplier of the medical person to the hospital/other institution is an ‘employment business’ providing staff who will be working under the ‘control’ of the institution in question or whether the supplier is controlling its own staff, as in the example of the dialysis clinic. Paragraph 6.3 of the notice defines an ‘employment business’ and para 6.4 gives us assurance that supplies of medical services by a self-employed locum doctor are only taxable if he is working for an employment business. In my opinion, the medical services exemption in this situation therefore extends to the locum doctor trading through his own limited company and invoicing an institution rather than employment business because his company is not an employment business so is not supplying staff. This would produce the same VAT outcome as the doctor being self-employed as a sole trader where there is no ‘employment’ twist in the equation ie we have complied with the concept of fiscal neutrality in that similar supplies carried out by different businesses are being taxed at the same rate.

HMRC Notice 701/57 para 6.7 - Supplies of contracted-out health services

As is clear from above, employment businesses in the health sector make a taxable supply of staff to third parties, such as hospitals or hospices, if the third party is legally responsible for the onward supply of providing care to the final recipient. This is subject to the nursing agencies' concession. The mere fact that an employment business is state-regulated does not mean that its supplies of staff are exempt if they are not covered by the nursing agencies' concession.

However, when state-regulated health providers provide health services to the final consumer, these services remain exempt even if they are contracted out and paid for by a hospital or other third party. For example, a NHS hospital may subcontract the provision of medical care to a separate clinic providing dialysis treatment. Although the NHS trust may pay the clinic for its services, this does not mean that the clinic has made a supply of staff to the NHS. This is because the clinic's staff will still be working under the direction and control of the clinic itself throughout the provision of the services rather than under the hospital trust.

As a final comment, be aware that although supplies by employment agencies generally relate to a supply of staff and are therefore standard rated, there is a 'nursing agencies concession' where supplies of nurses to third parties could be exempt from VAT rather than standard rated (HMRC Notice 701/57, para 6.5). The nurses must be providing some form of direct medical care to patients, such as testing blood pressure or administering drugs, rather than acting as a general care assistant carrying out eg the duty of washing the patient.

Second case – City Fresh Ltd

City Fresh Services Ltd (City Fresh) (TC4548) provided services to a related business City Dental Practice (CDP) and treated the supplies as exempt from VAT as medical care carried out by a qualified medical practitioner (dental services). HMRC viewed the supply as being of standard rated staff. The company had been set up in 2009 to deal with work carried out for a local NHS Trust. However, due to a contractual issue, the services were subsequently supplied to the Trust via CDP, with City Fresh acting as a subcontractor for CDP. So City Fresh raised a monthly invoice of £30,000 (VAT exempt) to CDP with effect from March 2010. The two directors of City Fresh were the only employees of the company (both qualified dentists) and were also the two partners in CDP. HMRC treated the company's supplies to CDP as taxable and registered it for VAT from August 2010.

The taxpayer argued that HMRC's view that a supply of staff was evident was flawed because the dentists were not under the 'control' of CDP – and were providing medical services through the company. There was nothing in the EU VAT Directive that indicated a supply of 'medical care' was only exempt if provided directly to a patient.

HMRC's view was that exemption could not apply in relation to medical services provided through another intermediate in a chain ie as in the case of City Fresh working for CDP. It was not possible for both City Fresh and CDP to be providing medical services to a patient – they were happy that CDP was providing exempt medical services to the NHS Trust but that supplies by City Fresh to CDP were taxable.

The tribunal agreed with the taxpayer's views and allowed the appeal. To quote from the report (para 36):

> "The legal form of the person providing medical care is not relevant, neither is the fact that the recipient is not the final patient; there is no need for supplies of medical care to be made direct to the final patient…. we agree with the Appellant that there is no basis for concluding, as HMRC seem to have done, that dentist services must be provided directly to a patient. HMRC did not provide any clear explanation of why they believed that to be the correct interpretation of the legislation."

It is strange that this case reached the courts – HMRC thought that medical services could not qualify for exemption if they involved a chain of different contractors – although they were satisfied that exemption could apply if one contractor was providing services to the NHS Trust ie CDP. This is bizarre because it could be argued that only the NHS Trust was providing services to the final patients. The tribunal sensibly considered the 'essential economic character of the supply' – which is that all parties were providing exempt medical care and City Fresh should not be classed as an 'employment business' supplying staff.

Conclusion

In reality, the key challenge is to look very closely at the contract between the medical professional and the institution he is working for, and focus completely on the 'staff v medical services' dilemma, to work out the VAT position. And if I have whetted your appetite on this subject, have a look at another recent First-tier Tribunal case, *Alice Duncan and Bascgalliwhite Ltd* (TC4109) about whether a health practitioner was providing medical or medico legal services – an interesting case and another HMRC win.

Contributed by Neil Warren