Tolley®CPD

February 2016

Disclaimer

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

Contents

Personal Tax

Cars were available for private use so not pool cars

Summary – The Tribunal determined the cars in question were not pool cars

The taxpayer was the director of a company that supplied modular homes in Europe. HMRC opened an enquiry because there were discrepancies between the taxpayer's 2008/09 tax return and form P11D in relation to a company car. According to the latter form, the company made two cars available to the taxpayer, along with free fuel. The taxpayer said the vehicles were pool cars, although he accepted that in previous years he had had the benefit of a company car.

The matter proceeded to the First-tier Tribunal.

Decision:

The judge noted that the cars were kept at the taxpayer's home address and that he was allowed to use them for private purposes. On this basis they were not pool cars but company cars. The taxpayer had made a careless error by not including the benefit in kind in his tax return.

The taxpayer's appeal was dismissed.

Comments – This case is an open and shut example of where the cars simply did not qualify for pool cars treatment. It is amazing how many people will argue in hopeless circumstances that a car qualifies as a pool car to avoid the benefit in kind tax charge. Having said that, there is now a really significant benefit-in-kind charge so an attempt might seem worthwhile. This is a case which acts as a reminder as we are coming up to the end of the tax year and the P11D season.

A Jubb v HMRC TC4760

Was a payment made for client connections an emolument?

Summary – The Upper Tribunal held the FTT had erred in its judgement and therefore allowed HMRC's appeals against SWCS and Patrick Smiley that a payment to Mr Smiley was not a capital receipt but an emolument from his employment

Smith & Williamson Corporate Services (SWCS) employed S, a fund manager, and members of his team as part of its strategy to increase the funds under management. They had previously worked for Butterfield Private Bank. Under a contract, S and his team agreed with SWCS's sister company, Smith & Williamson Investment Management, to deliver their client relationships for a goodwill payment. The issue was whether S's share of the payment was an emolument.

The First-tier Tribunal treated the client relationships as a capital asset and decided that the payment was not an emolument but a capital receipt. The payment was not therefore liable to income tax and National Insurance.

HMRC appealed.

Decision:

Mr Justice Warren in the Upper Tribunal said the team did not own or have any legal interest in the business carried on by Butterfield or in the goodwill. They had personal relationships with the bank's clients that they had built up over several years while employed there and at other businesses. They could introduce clients to Smith & Williamson Investment Management and agree to help transfer them and their funds.

Further, S's employment contract with SWCS and his contract with Smith & Williamson Investment Management were linked. The Smith & Williamson group had employed the team in “the hope and expectation” that some of the Butterfield clients would transfer with it. The “inevitable conclusion” was that the payment arose from the employment.

HMRC's appeal was allowed.

Comments - Whilst the decision in this case was long, the Judge’s actual conclusions were expressed quite shortly. Simply put, the payment in question was a reward to the team for introducing the clients to SWIM and as such, arose from the employment of the team by SWCS. It followed that the payments were therefore liable to income tax and NICs.

R&C Commissioners v Smith & Williamson Corporate Services: Smiley Upper Tribunal

Buy-to-let tax changes – problems and possible solutions (Lectures P936/ P937 – 20.52 /25.04 Minutes)

At present, full income tax relief is normally available for interest paid on a loan taken out by an individual for use in his property letting business. The funds may have been spent in purchasing the rental property, in making improvements to it, in providing furnishings and equipment such as cookers, fridges and washing machines for the tenants or simply in helping to finance the working capital of the business.

With effect from 6 April 2017, tax relief on interest relating to ordinary residential property businesses will be restricted so that, by 2020/21, such interest will no longer be an allowable deduction against the rental profits but instead will only be given as a 20% income tax reduction. Note that these new rules in S24 F(No2)A 2015 do not apply to owners of furnished holiday accommodation nor to landlords of rented commercial property.

A letting activity that has relatively modest interest outgoings will not be too badly affected, but, as one commentator has remarked, ‘larger property businesses using debt to expand the portfolio will find that their business model has been seriously undermined’. This can be illustrated by comparing two sets of individuals, the first a 40% taxpayer who owns a single buy-to-let and the second a married couple with a substantial property portfolio.

Illustration 1

George, who is 44 years of age, is a journalist. As a result of a small inheritance, he was able to purchase a buy-to-let property with the aid of a mortgage a few years ago. The outstanding debt on George's property is now relatively low. George is a 40% taxpayer. By comparing George's tax position in 2016/17 and in 2020/21, we can see the effect of this recent tax change:

	2016/17	2020/21
	£	£
Gross rents received	8,000	8,000
Less: Repairs and other allowable expenses	1,300	1,300
	6,700	
Less: Interest paid on mortgage	2,700	
Net rental profit	4,000	6,700
Income tax @ 40%	1,600	2,680
Less: Interest relief (20% x 2,700)		540
Net income tax liability	1,600	2,140

Tax increase £540

Effective rate on 'real' rental profit 40% 53.5%

If George decided to increase his borrowings in order to allow him to purchase a second buy-to-let, he will find that his 2020/21 tax rate would rise still further, given that his interest costs would now be higher and his net investment return lower.

Illustration 2

David and Samantha are a married couple and together they run a sizeable rental property business in their own names (ie. as joint owners).

They have no other income.

Because they have incurred significant bank borrowings, they are currently basic rate taxpayers.

Comparing their income tax position in 2016/17 with that in 2020/21 will produce a very different picture (2016/17 rates and figures have been used for the 2020/21 calculations):

		2016/17	2020/21
		£	£
Gross rents received		640,000	640,000
Less:	Repairs and other allowable expenses	220,000	220,000
		420,000	
Less:	Interest paid on mortgage	360,000	
Net rental profit		£60,000	£420,000
Income for each spouse		30,000	210,000
Less:	PA	11,000	
Taxable income		£19,000	£210,000
Income tax @	20%	3,800	6,400
	40%		47,200
	45%		27,000
			80,600
Less:	Interest relief (20% x 180,000)		36,000
Net income tax liability		3,800	44,600
Tax increase	£40,800		
Effective rate on 'real' rental profit		12.7%	148.7%

Because David and Samantha have no other employment or business interests, they each spend at least 35 hours a week on their residential property business. As can be seen, their cash return is modest, but that would appear to be because, in the past, they have ploughed most of their profits back into building up their property letting portfolio in order to grow the business. Unfortunately, their current business structure will soon be unsustainable.

What about property letting losses?

Another example where problems will arise occurs in the event of a rental property being let at a loss (ie. where the loan interest paid exceeds the letting income). The difficulties which this will cause are shown in the illustration overleaf.

Illustration 3

Theresa is a single parent who works from home and makes annual business profits of £24,000. She claims child benefit because she is a basic rate taxpayer. She lets out her former family home for a rental of £33,000 per annum – it is too large for her and her young son. The two of them live in a small rented flat. The let property has a large mortgage outstanding on which the annual interest is £35,000.

Theresa does not think that she will be affected by the relevant provisions in F(No2)A 2015 given that her marginal income tax rate is 20%.

On the assumption that Theresa's income, personal allowance and basic rate band limit remain constant at their 2016/17 levels, a comparison of her tax position for 2016/17 and 2020/21 makes interesting reading:

		2016/17	2020/21
		£	£
Business profits		24,000	24,000
Rental income		33,000	33,000
		57,000	
Less:	Interest deduction	33,000	
Total income		24,000	57,000
Less:	PA	11,000	11,000
Taxable income		£13,000	£46,000
Income tax @	20%	2,600	6,400
	40%		5,600
			12,000
Less:	Interest relief (20% x 33,000)		6,600
Net income tax liability		£2,600	£5,400

In 2020/21, Theresa is a higher rate taxpayer who loses most of her child benefit because her total income is over £50,000. The tax credit for her loan interest is calculated as the lowest of:

(i) her finance costs not deducted from income (£35,000);

(ii) the profits from her property letting business (£33,000); or

(iii) her taxable income (£46,000).

Theresa's property letting business has made an actual loss of £2,000, but, in 2020/21, she pays income tax of £5,400 of which £2,600 relates to her business profits. In other words, she pays income tax of £2,800 in 2020/21 on her loss-making property letting business!

Given that her interest costs of £35,000 are greater than the letting income of £33,000, she will be able to carry forward a tax reduction of 20% x £2,000 = £400 for set-off against her income tax liability in the following tax year.

In these circumstances, Theresa will have little choice but to sell her rental property, since she does not appear to have any other resources from which she could reduce her borrowings. Other landlords may be able to sell part of their property portfolio. Alternatively, they could look at restructuring their lettings business in one of the following ways:

(i) sell their residential properties and reinvest in commercial land and buildings;

(ii) let their residential properties as furnished holiday accommodation; or

(iii) transfer their business to a company.

Any one of these options will allow a full deduction of interest and other finance costs from the rents received, but the changeover to a company will involve important CGT and SDLT considerations.

Incorporation of a property letting business

Highly leveraged landlords of residential properties are likely to fall into the category of individual who will be worst affected by the F(No2)A 2015 legislation, especially if they are paying tax at 40% or 45%. It is already apparent that many of these taxpayers are giving serious consideration to the possibility of incorporating their property letting businesses in order to mitigate the adverse effect of the impending basic rate tax relief for interest.

In view of the fact that the limitation of tax relief for interest applies only to individual taxpayers, incorporation will clearly protect landlords from the new regime. Further tax will of course be payable on any profits extracted from the corporate structure, with the recently announced changes to dividend taxation making this more costly than before. However, where clients wish to reinvest some, or all, of their property letting profits back into the growth of the business, incorporation will nearly always be significantly more advantageous than personal ownership.

There are a number of factors which need careful analysis when contemplating a possible incorporation, eg. the administrative burden of a company and the effect which the corporate structure may have on borrowings, with banks typically charging higher rates of interest to a company. However, the tax charges which can arise on incorporation (in particular, CGT and SDLT), and the possibility of avoiding them, will often be the deciding factor.

CGT

Transferring a property portfolio to a connected company will normally give rise to a CGT charge on a deemed disposal at market value which can be an expensive exercise. However, where the rental properties have been actively managed, case law has shown that the activities can be treated as a business for CGT purposes, giving scope for reliance on the rollover relief available under S162 TCGA 1992. This requires that the business and all the business assets (other than cash) must be transferred as a going concern to the company wholly in return for shares. In this circumstance, the aggregate net gains on the properties are automatically rolled over against the base cost of the new shares. No claim is needed for relief under S162 TCGA 1992. It should be noted that this procedure gives the properties a tax uplift in the company, in view of the fact that they go into the company at current market value.

If the consideration given by the new company is not wholly satisfied by an issue of shares, there is a pro rata restriction of the relief so that some CGT may be payable. The assumption of a mortgage by the acquiring company would, strictly speaking, mean that the company has provided additional non-share consideration, but HMRC normally accept that bank debt represents a business liability so that this arrangement should be protected by ESC D32.

The question of whether property letting constitutes a business for CGT purposes has never been entirely clear-cut. However, the decision in Ramsay v HMRC (2013) provides, in the words of one tax expert, 'pretty robust authority for treating substantive property letting activities as a business for the purposes of S162 TCGA 1992 incorporation relief'. In that case, the Upper Tribunal ruled that activities ordinarily associated with the management of investment properties can be regarded as the running of a business. In particular, the Upper Tribunal held that the activities must:

- represent an undertaking which is being seriously pursued by the owner;
- be conducted on sound and recognised business principles; and
- be such as are commonly made by those who seek to profit from them.

Furthermore, the activities must be significant, with a reasonable amount of time being devoted to property-related work. In the Ramsay case, the taxpayer spent, on average, 20 hours a week managing and maintaining the properties. This case shows that it is the quantity, and not the quality, of the activity which is important. In the words of Berner J:

'Where the degree of activity outweighs what might normally be expected to be carried out by a mere passive investor, even a diligent and conscientious one, that will in my judgment amount to a business.'

It also helped that the property owner did not have any other employment or trade.

Do not overlook the possibility of using HMRC's non-statutory clearance service in order to determine whether or not a business is being carried on. There is a useful checklist at Annex A on the HMRC website for those who decide to follow this procedure.

SDLT

As a general rule, there is no SDLT charge when properties are transferred to a company for no consideration. However, there is an important exception to this principle in that S53 FA 2003 imposes a market value charge if:

- property is transferred to a company; and
- the transferor is connected with the company (see S1122 CTA 2010 for the meaning of 'connected').

Given that several rental properties will often be put into the company at the same time, this is likely to involve an unacceptably high SDLT charge since they will constitute 'linked' transactions (see S108 FA 2003). At present, the maximum rate is 12% on the top slice of the value acquired by the company.

There are two main ways by which this charge can be mitigated:

The first is to take advantage of an important deeming rule in S116(7) FA 2003 known as 'multiple dwellings relief'. This applies to the transfer of six or more separate dwellings in a single transaction and treats them collectively as 'non-residential' for SDLT purposes.

As a result, the SDLT payable by the company is limited to a 4% maximum (ie. the transaction is treated as though it was the acquisition of commercial property).

The second arrangement is more complicated but can sometimes eliminate the SDLT charge completely. It requires a partnership – or, better still, an LLP – to transfer the properties to the company and the relevant legislation is set out in Sch 15 FA 2003.

It is important to appreciate that the partnership SDLT provisions take priority over the market value rule in S53 FA 2003 – see Para SDLTM34160 of the Stamp Duty Land Tax Manual for confirmation of this statement.

The salient measure is found in Para 18 Sch 15 FA 2003 which uses the following formula to determine the quantum of the SDLT charge:

MV x (100 – SLP)%

where:

MV = the market value of the properties transferred; and

SLP = the 'sum of the lower proportions'.

The SLP definition is provided by Para 20 Sch 15 FA 2003. This involves what is essentially a three-step procedure:

Step One

Identify the partners who are connected persons and who have an interest in the properties after the transaction (ie. through their shareholdings) – they are known as 'relevant owners'.

Step Two

For each relevant owner, find their percentage interest in the properties after the transaction.

Step Three

Add together all these percentage interests – this produces the SLP percentage.

Note that the SLP will be 100 where these partners (eg. husband and wife or mother and daughter) become the only shareholders in the new company. In these circumstances, the application of the above formula will always produce a tax rate of 0%. This is the case even if the aggregate market value of the properties transferred into the company is, say, £5,000,000.

In order for the SDLT advantage described above to apply, the transfer must be from a partnership (or LLP). This is not the same as joint ownership.

One key factor is likely to be whether the partners have submitted their relevant tax details on the partnership pages of a self-assessment tax return. In other words, is there a proper partnership?

Although, in the past, the courts have considered a number of aspects when they have been called upon to determine whether or not a partnership exists, the three main requirements, in the speaker's view, to establish the reality of such an arrangement are that:

1. there is a written partnership agreement in place;
2. there is a separate partnership bank account; and
3. the partners genuinely share both profits and losses.

In this context, it is important to realise that there is anti-avoidance legislation in S75A FA 2003 which prevents an individual who is running a property letting business on his own from forming a partnership with, say, a spouse or a brother and, shortly afterwards, incorporating that partnership in order to enjoy the SDLT benefit.

Finally, let us consider, in the illustration below, the financial details of a taxpayer who has incorporated a reasonably highly geared property business which will demonstrate quite how much tax can be saved by operating through a company (notwithstanding the 2016/17 dividend tax changes)

Illustration 4

Philip and Susan are equal partners in a residential property rental business that has been running for eight years. They own 12 flats in Weybridge, all of which are let. The market value of the properties is estimated to be £3,600,000. Their net rental income is £162,000, but, because the flats were originally financed with the aid of a mortgage, they incur annual interest of £90,000.

Both spouses are 45% taxpayers, given that they are also joint owners of a very successful trading business that is run for them by a manager.

The income tax position on their property income for 2016/17 and 2020/21 will be as follows (it is assumed that rates of tax will not change between 2016/17 and 2020/21):

	2016/17	2020/21
	£	£
Net rents received	162,000	162,000
Less: Interest paid on mortgage	90,000	
Net rental profit	£72,000	£162,000
Income tax @ 45%	32,400	72,900
Less: Interest relief (20% x 90,000)		18,000
Net income tax liability	32,400	54,900

Tax increase £22,500

As a result of these forecast calculations, Philip and Susan decide to incorporate their residential property business and so they form Hammond Property Ltd with 100 ordinary shares of £1 each. Husband and wife each take 50 ordinary shares in the new company.

The property gains are rolled over against the base cost of Philip and Susan's shares in Hammond Property Ltd under S162 TCGA 1992 and there is no SDLT on the acquisition of the 12 flats by the company from the partnership because of the SLP formula.

Before the incorporation, the couple's after-tax income was (using 2020/21 figures):

		£
Net rents received		162,000
Less:	Interest paid	90,000
	Income tax	54,900
		17,100

On the assumption that we look at Hammond Property Ltd for the year ended 31 March 2021, the company's position is:

		£
Net rents received		162,000
Less:	Interest paid	90,000
Pre-tax profits		72,000

Corporation tax @ 18%	£12,960

The post-tax profits available for distribution are:

		£
Pre-tax profits		72,000
Less:	Corporation tax	12,960
Post-tax profits		59,040

If this is then distributed by way of dividend to the two 45% taxpayers, their after-tax position will be:

		£
Dividend to Philip and Susan		59,040
Less:	Income tax (59,040 – 10,000 = 49,040 @ 38.1%)	18,684
		40,356

This represents a significant improvement on their pre-incorporation position.

Contributed by Robert Jamieson

Property letting business deductions (Lecture P938 – 15.15 minutes)

Clause 40 of the draft Finance Bill, along with its accompanying Schedule, introduces a redesigned form of deduction for capital expenditure incurred by landlords in replacing furnishings, appliances and kitchenware provided for the use of their tenants in residential properties.

This deduction has effect for expenditure incurred:

- on or after 6 April 2016 for income tax purposes; and
- on or after 1 April 2016 for corporation tax purposes.

A new S311A ITTOIA 2005 has been inserted into the income tax code which provides for a deduction to be given against the profits of the property letting business where the following conditions are satisfied:

- a person carries on a letting business which involves one or more residential properties;
- that person incurs expenditure on a replacement domestic item which is made available solely for the tenant's use in the property;
- the expenditure is of a capital nature; and
- no capital allowances are available in respect of this expenditure (S311A(2) – (6) ITTOIA 2005).

However, S311A(7) ITTOA 2005 prohibits a deduction if the property qualifies as furnished holiday accommodation. Nor is relief available if the property is the subject of a rent-a-room relief claim (S311A(8) ITTOIA 2005).

HMRC have confirmed that the new relief will apply to:

- movable furniture or furnishings such as beds and sofas;
- televisions;
- fridges and freezers;
- carpets and floor coverings;
- curtains;
- linen; and
- crockery and cutlery.

Fixtures integral to the building which are not normally removed by the owner if the property changes hands are not included (see S311A(12) ITTOIA 2005). This is because the replacement cost of such items would anyway be a deductible revenue expense as a repair. Typical fixtures include:

- baths and showers;
- washbasins;
- loos;
- boilers;
- radiators; and
- fitted kitchen units (eg. a built-in double oven).

S311A(9) ITTOIA 2005 provides that the amount of any deduction is the expenditure incurred on the replacement item, unless it is not substantially the same as the old item. In such a case, the deduction is limited to the amount of the expenditure which would have been incurred on an item which was substantially the same. In other words, if the landlord replaces a washing machine with a more sophisticated washer-dryer, it will be necessary to subtract the cost of the improvement element from the replacement expenditure.

A landlord's allowable deduction can be augmented by any incidental capital expenditure which he incurs in connection with:

- the disposal of the old item; or
- the purchase of the new item (S311A(10) ITTOIA 2005).

Very similar provisions for corporate landlords can be found in S250A CTA 2009.

As a result, the 10% wear and tear allowance legislation in ITTOIA 2005 and CTA 2009 is repealed. So, too, are the renewal allowance rules in S68 ITTOIA 2005 and S68 CTA 2009.

Contributed by Robert Jamieson

Capital Taxes

Company distributions – capital or income? (Lecture P939 – 21.19 minutes)

Many successful private companies accumulate cash and, if the shareholders do not have an immediate need for the funds, there is no reason why the reserves should be distributed, thereby creating an unnecessary income tax charge. Indeed, the new dividend tax rates, which take effect on 6 April 2016 for dividend receipts in excess of £5,000 (7.5%, 32.5% or 38.1%), will make it even less attractive to pay out funds which are not needed for personal expenditure or investment. It is anticipated that a considerable number of companies will rethink their distribution strategies in the light of this revised dividend regime.

In such circumstances, companies will continue to accumulate profits until one of the following events occurs:

(i) the sale of the company to a third party;

(ii) the purchase by the company of some of its own shares;

(iii) the repayment of some of the company's share capital; or

(iv) the liquidation of the company.

In each of these situations, the shareholder will receive a payment which is taxed as a capital gain and so he will be liable to CGT at a rate of 10% (if entrepreneurs' relief is in point) or at a rate of 18% and/or 28% (in any other case). Such payments will not normally be treated as income. Note, however, that distributions made as part of an informal winding up (ie. under S1003 Companies Act 2006) will nowadays be taxed as income where the total amount received exceeds £25,000 (S1030A CTA 2010).

The Government believe that shareholders are increasingly seeking to enjoy a fiscal advantage by being charged to tax on gains rather than on income and so, as part of an ongoing consultation which started last year, they are proposing changes to the tax treatment of company distributions. At the moment, these will only affect individual shareholders – there are no alterations proposed for the corporate tax position. However, this may not be the end of the matter, given that the consultation document suggests the future possibility of a more wide-ranging examination of various approaches which might be adopted to prevent the conversion of income to capital for tax planning reasons (including, rather worryingly, the reintroduction of the close company apportionment legislation).

Clause 18 of the draft Finance Bill introduces a targeted anti-avoidance rule (TAAR) which will apply to certain company distributions in respect of share capital on a winding up. This TAAR, which will be relevant for distributions made on or after 6 April 2016, comes in the form of a new S396B ITTOIA 2005 and specifically treats a distribution on a winding up as an income distribution, but only where certain conditions are met.

The legislation is aimed at what is known as 'phoenixism': this is when a profitable company enters into a members' voluntary liquidation and a new company is set up to replace the old one and to carry on the same (or substantially the same) activities – in this case, the shareholders receive all the value of the company in a capital form while the trade continues (albeit now in the new company) exactly as before.

In order for the anti-avoidance legislation in S396B ITTOIA 2005 to bite, there are three requirements:

(i) an individual, who is a shareholder in a close company, receives a distribution from that company in respect of his shares on a winding up;

(ii) within a period of two years following the date on which that distribution was made, the individual (or a person connected with him) is involved in a similar trade or activity; and

(iii) it is reasonable to assume, having regard to all the circumstances, that the main purpose (or one of the main purposes) of the arrangements is the obtaining of a tax advantage (S396B(2) – (4) ITTOIA 2005).

There is a specific let-out for assets distributed to an individual which consist of irredeemable shares in a subsidiary of the company being wound up (S396B(6) ITTOIA 2005). This is clearly intended to ensure that liquidation demergers of close company groups cannot fall within the scope of the new TAAR.

Illustration

Steven runs a successful stud farm through a family company called Shores Ltd. He has recently been approached by someone who wants to buy the business but has no need of the company.

Shores Ltd is therefore put into liquidation shortly after the business sale goes through and Steven ends up paying 10% CGT on this transaction, having made an appropriate entrepreneurs' relief claim.

If there is any likelihood that Steven (or possibly his wife) might want to set up a new stud farm business within the next two years, he would have to consider whether the TAAR might affect the tax paid on the recent sale.

Because the TAAR applies to distributions made on or after 6 April 2016, a liquidation which is already in progress must be completed before 6 April 2016 in order to fall outside the new legislation.

In addition, to provide a further measure of protection, the Government plan to amend and update the 'transaction in securities' rules in Part 13 of ITA 2007. The new legislation is set out in clauses 16 and 17 of the draft Finance Bill.

Briefly, these changes:

(i) introduce what HMRC call a 'connected parties' regime into S684(1) ITA 2007 in order to ensure that the legislation cannot simply be avoided by arranging an advantage on someone else's behalf or by exploiting family and other relationships (including those involving trusts and companies);

(ii) confirm that the rules look at the reserves available within a group rather than a particular company so that the impact of Part 13 of ITA 2007 cannot be sidestepped by the simple expedient of having profits widely dispersed within a group (see the revised version of S685 ITA 2007);

(iii) redefine the 'fundamental change of ownership' exclusion in S686 ITA 2007 so that it can continue to act as a 'safe harbour' for disposals, but in a way which is not so open to abuse'; and

(iv) define more fully what constitutes a transaction in securities – by virtue of the amendments to S684(2) ITA 2007, the legislation makes it clear that all of the following can be treated as transactions in securities:

- a repayment of share capital or share premium; and
- a liquidation.

The procedural rules for counteraction are also being changed so that they operate in a similar fashion to the self-assessment compliance provisions. Rather oddly, they were not amended when self-assessment arrived on the scene in the 1990s.

The main changes above apply to transactions occurring on or after 6 April 2016.

Article by Robert Jamieson

Dispute over domicile

Summary – The Upper Tribunal confirmed that the taxpayer could not have his domicile issue dealt with as a preliminary matter.

The taxpayer was born in Dublin, educated in the UK, and married to a Swiss woman with whom he lived in Switzerland and London. In 2001, he told HMRC that he was not domiciled in the UK from 2000.

HMRC opened an enquiry in 2001 and issued determinations for 2000/01 to 2007/08 on the basis the taxpayer was domiciled in England and Wales during those years. The taxpayer appealed and applied to the First-tier Tribunal for a preliminary hearing to determine his domicile of origin.

The First-tier Tribunal concluded that the taxpayer's domicile of origin could not be divorced from the substantive issue: his domicile between 2000/01 to 2007/08, and refused the application.

The taxpayer appealed to the Upper Tribunal.

Decision:

The Upper Tribunal concluded that the lower chamber had been correct.

The judge said a decision on the taxpayer's domicile of origin would “not dispose of the whole case or a separate aspect of the case”. A preliminary hearing would increase the time and resources to resolve the appeal.

Further, he was “not persuaded that the difference it might make to the appellant's pre-trial preparation” was a material consideration, given that the factual enquiry would remain the same and the taxpayer always had a choice about the evidence he wished to offer.

The taxpayer's application for the domicile of origin issue to be determined as a preliminary issue was dismissed.

Comments – This is a useful reminder of the rules regarding domicile and the types: origin and choice appearing in this particular case. Even though there will be new rules coming in with regard to deemed domicile and long term residents the main rules will still apply to determine certain cases.

The Right Honourable Clifton Hugh Lancelot de Verdon Baron Wrottesley v CRC, Upper Tribunal

Satisfying conditions for negligible value relief?

Summary – The FTT rejected the taxpayer’s claim for s131 ITA 2007 relief as the conditions were not met

In 2007/08, the taxpayers acquired shares in CALA. These had become of negligible value at 6 April 2010. They claimed share loss relief against their income.

HMRC accepted that the taxpayers were entitled to claim a capital loss, but not that they satisfied the conditions to set it against income under ITA 2007, s 131. To qualify they had to show that the shares were in a qualifying trading company, as described in s 134.

Decision:

The First-tier Tribunal said the company was a property developer. It built houses and sold them, along with the land. So while the company traded, its business of property development was excluded under s 192(1)(g) and s 196. The appeal failed on this basis.

However, the tribunal added that because the company's gross assets exceeded the £7m and £8m ceiling, it also failed the gross asset tests.

The taxpayer's appeal was dismissed.

Comments – It sounds like a statement of the obvious that when making a claim for loss relief as with many other things in tax the conditions need to be met. As the Tribunal determined the trade was an excluded trade and in addition it failed the gross assets test. A clear cut decision although not what the taxpayer wanted.

P Brown and others v HMRC TC4780

New reliefs from the SDLT higher rate (Lecture P940 – 13.54 minutes)

Sch 4A FA 2003 provides for a 15% charge to SDLT where there is a property acquisition of a 'higher threshold interest' by a non-natural person such as a company or corporate partnership. The term 'higher threshold interest' is defined as an interest in a single dwelling which costs more than £500,000.

The legislation contains a number of reliefs aimed at genuine business acquisitions (eg. the purchase of one or more rental properties) that reduce the charge to the standard rate of SDLT. This relief is withdrawn if, at any time within a period of three years from the date of completion of the transaction, the property is held for a non-qualifying purpose.

Four new reliefs are being proposed within three clauses.

Clause 51

Clause 51 of the draft Finance Bill introduces amendments to Sch 4A FA 2003 so that the SDLT higher rate will not apply in connection with land transactions completed on or after 1 April 2016 in two sets of circumstances:

1. where the property is acquired for the purposes of providing living accommodation to an employee of a property rental business (employees of trading businesses are already covered); and
2. where a tenant-run management company purchases a flat for a caretaker who will be employed to manage and maintain the building (which will usually be a block of flats).

Clause 52

Under certain equity release schemes (in particular, home reversion plans), an individual sells his house to a financial institution in return for a lump sum and a lifetime tenancy. The individual can live in the property rent-free until death or on entering into a long-term care arrangement, at which point the property is sold. Under such a scheme, the interest in the property acquired by the equity release company is not currently protected from the 15% SDLT charge. Clause 52 of the draft Finance Bill provides relief for a transaction completed on or after 1 April 2016, provided that:

- the arrangement is a regulated home reversion plan; and
- the financial institution is appropriately authorised.

Clause 53

The third relieving provision is found in clause 53 of the draft Finance Bill. This measure introduces a relief from the 15% SDLT rate where a purchaser carries on a 'relievable trade' (ie. any trade conducted on a commercial basis and with a view to profit) and acquires, on or after 1 April 2016, an interest in a dwelling where the property has been purchased:

- for conversion into non-residential use in connection with the trade; or
- for permanent demolition in preparation for using the land for the purposes of the trade.

In addition, for chargeable periods beginning on or after 1 April 2016, properties falling into Clause 51 or 52 above will be outside the scope of an ATED charge – see clauses 54 and 55 of the draft Finance Bill.

Administration

Penalties for late CIS returns - Appeal partially successful

Summary – The FTT determined that s98A penalties were valid although other penalties were out of time

The taxpayer was a builder. He used subcontractors but was unaware that he should make monthly returns under the construction industry scheme. As the result of an enquiry, HMRC issued determinations and penalties for the years 2009/10 to 2012/13. The TMA 1970, s 98A penalties amounted to £88,800 while those under FA 2009, Sch 55 were £3,043.50. HMRC offered to mitigate the s 98A penalties to £3,370.63 and confirmed they would reduce them regardless of the outcome of the appeal.

At the First-tier Tribunal, the taxpayer said, even after mitigation, the penalties were more than 100% of the tax "lost". This was more than a deliberate tax wrongdoer would suffer, the penalties being at most 70%, while non-deliberate faults would be penalised at 10% to 15%.

Decision:

The tribunal judge said:

> "Whatever we might think about a system which allows someone who had failed to make returns of payments to subcontractors, which, when made, showed that they should have deducted and accounted for tax of less than £3,000, to rack up penalties of £88,000 … we know from *Bosher* [TC2307] … that the scheme of penalties is not disproportionate in terms of the European Convention on Human Rights because of the power given to HMRC to mitigate…"

He said the taxpayer's analogy with penalties imposed on tax cheats was not comparing like with like because, under the construction industry scheme, the tax due was not the taxpayer's but that from the workers.

The tribunal concluded that the s 98A penalties should stand because the taxpayer had no reasonable excuse for not making monthly returns. However, some of the Sch 55 penalty assessments were out of time and were cancelled.

The taxpayer's appeal was allowed in part.

Comments – This case demonstrates how really significant penalties can be racked up very quickly under the Construction Industry Scheme. It also highlights how the level of the penalties can seem to be incredibly unfair when compared with some of the other penalty regimes. Taxpayers must comply with the law or suffer "dire" consequences.

R Whitten v HMRC TC4652

Quantum of assessments was correct so discovery was permitted

Summary – The Tribunal upheld discovery penalties

The taxpayer appealed against discovery assessments for the years 1998/99 to 2005/06 made by the Serious Organised Crime Agency (SOCA) (now the National Crime Agency) in August 2011. He had acquired several properties between 1998 and 2005 and in 2005/06 sold four. HMRC issued him tax returns but he failed to file any.

In April 2007, the Asset Recovery Agency (which became SOCA) served a s 317 notice under the Proceeds of Crime Act 2002 on HMRC because the taxpayer held a large number of properties and a large quantity of cash but had no explanation of how he had accumulated them. This resulted in the discovery assessments. The taxpayer appealed.

His first ground of appeal — whether SOCA had the right to raise assessments — was determined against him in a preliminary hearing of the First-tier Tribunal in July 2013. The sole issue in the instant appeal concerned the quantum of the assessments.

Decision:

The tribunal said it was clear from the unexplained deposits and the lack of any credible reason for them that the taxpayer had received income and gains in the relevant years in which a loss of tax arose. Given that the loss was because of the taxpayer's deliberate conduct in not declaring the sums, the tribunal was content that the conditions in s29 TMA 1970 for raising discovery assessments were satisfied.

The judge said further that the assessments had been made on "reasonable inferences" on the known facts. It was the taxpayer's responsibility to produce evidence to displace the assessments but he had not done so. The tribunal therefore confirmed the assessments and dismissed the taxpayer's appeal.

Comments – This demonstrates the need to be able to justify figures which are unexplained – The judge said it was clear from the unexplained deposits and the lack of any credible reason for them that the taxpayer had received income and gains in the relevant years in which a loss of tax arose - It was the taxpayer's responsibility to produce evidence to displace the assessments

B Pepper v HMRC TC4757

HMRC's system failure contributed to failure to file online

Summary – The Tribunal determined that HMRC's computer problems had given rise to a reasonable excuse

The taxpayer appointed an accountant, H, to deal with her trust and estate self-assessment return. H submitted a paper form 64-8 to HMRC because they had been unable to request authorisation electronically.

HMRC said they received a paper return to which the 64-8 was attached with a covering letter on 6 January. The letter stated that the accountant had no access to HMRC's website to submit the return electronically. They issued a penalty for failure to file online.

The accountant appealed on behalf of the taxpayer, saying they believed they would be unable to make an online submission without 64-8 authorisation and that they did not have access to third-party software. HMRC refused the appeal on the basis that the accountant was “required to buy commercial software”.

Decision:

The First-tier Tribunal accepted H's statement that, had they been able to file the 64-8 successfully online, they would have been able to obtain software to submit the return electronically. However, HMRC's system had not functioned properly. The taxpayer had acted “entirely reasonably” in appointing an adviser and had tried to comply with her obligations. Her appeal was allowed.

Commentary – This case demonstrates how important the Tribunal system is as the process did not operate as it should have done and therefore the Tribunal was able to take an impartial view and hence allowed the appeal as the taxpayer had acted “entirely reasonably” in appointing an adviser and had tried to comply with her obligations.

V Todd v HMRC TC4700

Reasonable excuse for failure to submit a return online

Summary – The tribunal determined that the taxpayer had a reasonable excuse

The taxpayer and her husband filed their 2012/13 tax returns on 31 January 2014 and paid the tax shown on the computation. On 18 February, the taxpayer received a £100 late filing penalty. She wrote to HMRC explaining that she had submitted her return by the deadline. HMRC replied saying they were treating the letter as an appeal and had not received the return. They added that, if the return had been submitted, the taxpayer would have received a confirmation email. The matter proceeded to the First-tier Tribunal.

Decision:

The tribunal found there was no record of the tax return on HMRC's system and therefore the taxpayer had failed to file on time.

The judge went on to consider whether the taxpayer had a reasonable excuse for the late return. He decided she had. When HMRC told her that a “possible glitch” in the system had led to her return not being captured, she resubmitted it in a reasonable time. Further, previous years' returns had been successfully submitted and, on HMRC's insistence that a confirmation email would have been sent had the form been received, the judge agreed that this would happen only if the taxpayer had signed up to receive such emails. She had not.

The taxpayer's appeal was allowed.

Comments – This is yet another case which demonstrates the importance of record-keeping. The system does not operate as flawlessly as could be wished. Taxpayers are less familiar with the system than HMRC and despite HMRC's insistence that a confirmation email would have been sent had the form been received, the judge agreed that this would happen only if the taxpayer had signed up to receive such emails. She had not.

A Hauser v HMRC TC4799

"Deliberate error not concealed" VAT penalty?

Summary – The Tribunal found that a deliberate error penalty was appropriate

The taxpayer had been VAT registered since 2005 as a property business. In June 2011, he decided to start a chauffeur service and bought three new cars. He claimed input tax on the basis that he intended to use them in his new business.

HMRC said the taxpayer needed to provide evidence of the new business which he was unable to do. The claim was disallowed therefore on the basis that the cars were used for private purposes rather than business. The officer also charged a penalty equivalent to 47.25% of the tax overclaimed on the ground that the taxpayer's behaviour fell within the category of "deliberate behaviour without concealment" (FA 2007, Sch 24 para 3(1)(b)).

In October 2014, it was established that no VAT had been charged by the seller on one of the vehicles. HMRC said the taxpayer's reluctance to produce the invoice for the particular vehicle was further evidence of "deliberate" behaviour to underpay VAT.

Decision:

The First-tier Tribunal noted that, when the taxpayer bought the vehicles, he did not insure them for commercial use and there was no evidence to demonstrate a "firm intention" to begin a chauffeur business. The judge decided the taxpayer was aware the cars were not being used for business purposes when he submitted the input tax claim. It was therefore inaccurate and the penalty was appropriate.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, commented: "The taxpayer's argument against the 'deliberate' behaviour issue was not helped by the fact that he had claimed input tax on a private car in 2008, which was also disallowed by HMRC, and he had been advised about the need for all input tax claims to be relevant to taxable sales and the limited scope to claim input tax on cars. The key approach with penalties is to consider the behaviour of a taxpayer when a VAT return is submitted; at the time he submitted his November 2011 return, the taxpayer clearly had no intention of starting a chauffeuring business."

R Narroya v HMRC TC4699

Update on auto-enrolment (Lecture B938 – 15.55 minutes)

Many agents will be familiar with the concept of automatic enrolment but many smaller employers are not - hence the need for the TV ads for the 'workplace pension' featuring a large furry creature consistently ignored by various groups of people.

Even employers who have already implemented automatic enrolment are not in the clear as there are ongoing requirements, including **automatic re-enrolment** which crops up at least every three years.

The automatic enrolment regime was established under the Pension Act 2008, and imposes a duty on employers in England and Wales to make arrangements for the automatic enrolment of all of their 'eligible jobholders' into a 'qualifying scheme', which is also called the 'workplace pension'.

Employers are also required to contribute to that scheme on behalf of eligible jobholders.

Automatic enrolment by an employer means that the eligible jobholder becomes a member of a qualifying pension scheme without any action required on his part.

There is **no lower limit** of the number of employees an employer has before he has to consider automatic enrolment.

It **really matters** if employers do not comply. There is a range of escalating sanctions, not just fines but, in extreme cases, a criminal offence that can result in imprisonment of up to two years.

When does the employer have to operate automatic enrolment?

The obligation on employers to operate automatic enrolment is being introduced in stages in a process that started on 1 October 2012 but is still ongoing for employers who had fewer than 30 people their PAYE scheme in April 2012 or who have started employing people since that time.

The date on which an employer must implement the new regime is called its 'staging date'. Employers not yet within the regime should ensure they prepare for implementation of automatic enrolment well in advance of their staging date. The long tail of remaining staging dates runs on to February 2018.

The regime is policed by **The Pensions Regulator**. There is loads of employer-facing guidance on the Pensions Regulator's website (including staging dates) as well as more detailed guidance for advisers.

What does employer have to do?

Before the initial automatic enrolment at the staging date, the employer must review all his workers and decide which are:

- Eligible jobholders
- Non-eligible jobholders
- Entitled workers

Each of these groups is treated differently.

Some people on the payroll are not workers for this purpose and so outside automatic enrolment, examples include:

- Company directors who don't also have an employment contract
- People ordinarily working outside UK but case law has established they must not be "based" here

The remainder of the employer's workforce will fall into one of the three groups:

Eligible jobholders	Non-eligible jobholders	Entitled workers
Aged 22 or over but still below state pension age who earn more than an earnings trigger (currently £10,000 a year)	Those in the same age range whose earnings are between a lower boundary (currently £5,824) and £10,000	Those aged 16-75 whose earnings are below the lower boundary (ie less than £5,824 a year)
Must be automatically enrolled into qualifying pension scheme (although they do have the right to opt out).	Must be offered the opportunity to opt in to the employer's qualifying pension scheme.	Have a right to join an employer-sponsored pension scheme, but it does not have to be the qualifying scheme used for automatic enrolment
Employer contributions mandatory unless worker has opted out	Employer contributions mandatory if worker has opted in	Employer contributions optional

Opt-outs

The employer must let eligible jobholders know about their rights under automatic-enrolment, including the right to opt-out, but must be careful to do nothing to pressurise or even encourage opt-outs. The Pensions Regulator can apply penalties to any employer who does so try to influence a jobholder to opt out.

In making the decision whether or not to opt out, employees may have to consider their position in relation to the Lifetime Allowance (LTA) for pension contributions. If the employee has registered for any of the various Protections against the lifetime allowance charge which have been offered each time the LTA has been reduced he risks losing that protection if he does not opt out as one of the conditions for the protection is that no further pension contributions should be made.

An opt-out only last for three years – after that time the jobholder will once again be assessed as part of the automatic re-enrolment process and if he is still an eligible jobholder at that time, will once again be automatically re-enrolled, with a fresh opportunity to opt out (more on re-enrolment later).

What type of pension scheme can the employer use?

If the employer is to automatically enrol workers into a workplace pension it is stating the obvious that he needs to have pension scheme ready before the staging date to enrol those workers into.

Employers may have existing scheme suitable for the purpose or they may set up a new scheme. Alternatively employers (particularly smaller employers) may choose to use the National Employment Savings Trust ('NEST') which was created for the purposes of automatic enrolment and designed to operate on a defined contribution basis.

Whatever scheme is used, it must be a **qualifying scheme** – this can be and occupational scheme or a personal pension scheme and can be a defined benefit (DB), defined contribution (DC) or a hybrid scheme. There are different rules for each type of scheme but an essential requirement is either the rate of accrual of benefits or the level of contributions must be over a certain percentage of the worker's earnings.

For DC schemes, there is an *overall* minimum level of contributions (employer and employee), within which there is also a minimum level of employer contributions.

The employer can use more than one scheme – so that different schemes with different features can be offered to the various segments of the workforce.

Certifying compliance

Once the employer has sorted out his workers and fulfilled his automatic enrolment obligations in respect of each category, he must self-certify compliance with the automatic enrolment regime with the Pensions Regulator. This has to be done online within 5 months of the employer's staging date.

New employees

The obligation to apply the automatic enrolment rules applies on an ongoing basis after the employer's staging date. This means that all new employees have to be categorised on joining the workforce and if they are eligible jobholders they must be automatically enrolled in a qualifying scheme within three months of their start date (with the usual right to opt out).

Similarly if a worker becomes an eligible worker for the first time, the employer must automatically enrol him (with the usual right of opt-out).

Automatic re-enrolment

The Pensions Regulator takes a continued interest in employers' ongoing compliance with the regime. Three years after the employer's staging date, there is a requirement to re-register compliance with the regime. This means re-assessing anyone who has previously opted out of automatic enrolment and, if they fall into the description of eligible jobholder, they must be re-enrolled into a qualifying scheme – but can at that point opt out for a further 3 years.

The deadline for re-certifying compliance depends on whether the employer has any eligible jobholders to re-enrol. If there are none, the deadline is the 3rd anniversary of the original certification of compliance. If there are eligible jobholders to re-enrol, the employer can choose a 'cyclical re-enrolment date (within a 6-month window) and must re-certify compliance within 2 months of that date.

This is repeated every three years for as long as the employer continues to have any employees.

In addition to the official guidance on the Pension regulator's website, this topic is covered fully in TolleyGuidance.

Deadline Dates

1 February 2016

- £100 penalty is due and there is an extended enquiry window if 2015 self-assessment tax returns are not filed on or by 31 January 2016.
- Due date of payment of corporation tax liabilities for accounting periods ended 30 April 2015 for SMEs not liable to pay by instalments.

2 February 2016

- Due date of filing for P46(Car) for quarter ended 5 January 2016.

3 February 2016

- End of consultation period for the Finance Bill 2016 draft clauses published on 9 December 2015.

7 February 2016

- Due date for filing VAT returns and payment for 31 December 2015 quarter (electronic payment).

14 February 2016

- Due date for quarterly corporation tax instalment for large companies
- Filing date for monthly EC sales list if paper return used.
- Due date to apply to defer class 1 NICs for 2015/16, subject to approval of deferred employer(s).

19 February 2016

- Due date to pay PAYE, National Insurance, construction industry scheme and student loan liabilities for month ended 5 February 2016 if not paying electronically.
- Due date to file monthly construction industry scheme return.

21 February 2016

- File online monthly EC sales list by this date.
- Submit supplementary Intrastat declarations for January 2016 by this date.

22 February 2016

- PAYE, National Insurance, construction industry scheme and student loan liabilities should have cleared HMRC's bank account by this date.

28/29 February 2016

- Payment of 2015/16 self-assessment liabilities after this date will be subject to a 5% surcharge. (This deadline may be deferred if liability notified by 5 October 2015.)
- Companies House must receive accounts of private companies with 31 May 2015 year end.
- Companies House must receive accounts of PLC companies with 31 August 2015 year ends.
- HMRC should have received corporation tax self-assessment returns for companies with accounting periods ended 28 February 2015 by this date.

HMRC News

Making Tax Digital – Discussion paper on simpler payments

Introduction

The government is revolutionising the services it provides to taxpayers and committed at Autumn Statement to invest £1.3bn to transform HMRC into one of the most digitally advanced tax administrations in the world. At the heart of this will be simple, secure and personalised digital tax accounts, bringing an end to the tax return.

On 14 December 2015 the government published the Making Tax Digital roadmap which sets out in more detail how this transformation will be achieved both for businesses and for individual taxpayers. This includes transforming the tax system so that it operates much more closely to 'real time'.

The roadmap sets out how, by 2020, most businesses, to include companies, partnerships and individual taxpayers who are self-employed and those letting out property, will be required to keep track of their tax affairs digitally and update HMRC at least quarterly. By reporting information closer to real time, businesses will find it easier to understand how much tax they owe, giving them far more certainty over their tax position and helping them to budget accordingly.

For individual taxpayers, the roadmap sets out how, from 2017, HMRC will make much better use of the real-time data received from employers operating PAYE – and other information from third parties – to reduce over and underpayments.

The roadmap also indicates that the government will consult on the issue of payment – on options to simplify the payment of taxes, align payment arrangements and bring payment dates closer to the time of the activity or transactions generating the tax liability.

HMRC will be running a series of consultation events in January and February to discuss these payment issues with stakeholders. This document is intended to set out the context for these events and to set out the agenda for discussion.

These events will not consider Corporation Tax (CT) arrangements in respect of the largest companies (broadly those who have more than £20m profits in a 12 month accounting period) since the government has already announced reforms to Quarterly Instalment Payment (QIPs) for this group. However, they will consider payment arrangements for the remainder of the CT population, Income Tax Self Assessment (ITSA), Value Added Tax (VAT), Class 4 National Insurance Contributions (NICs) and other taxes collected through the Self Assessment process.

Simplifying Payment

Making Tax Digital provides an opportunity to consider how HMRC can simplify payment arrangements for taxpayers. The current arrangements have developed over decades in a way that made sense for those taxes at the time but leaves many different payment systems which are confusing for taxpayers and lead to error.

Example: Complexity for unincorporated businesses

The arrangements for unincorporated businesses within the current Self Assessment (SA) system are complex, governed by basis period rules that determine how periods of account are mapped to the tax year. These rules mean that there is a long lag between the start of trading and the first payment of tax and can result in some or all of the first year's profit being taxed twice. Even when unincorporated businesses are established, there are variable lags between the profits being generated and the tax being paid. Neither are the payments on account due in January and July under the SA system based on up-to-date data but on the tax due and paid in the previous year

Making Tax Digital also presents an opportunity to align payment arrangements across different taxes and to provide a more joined-up service for taxpayers. The government has already brought the collection of Class 2 National Insurance Contributions (NICs) for the self-employed into the arrangements for self-assessment, which means that from April 2015, Class 2 NICs are now collected alongside Class 4 NICs for most. The government is also consulting on the abolition of Class 2 NICs and reform of Class 4 to further simplify the system.

We envisage that, for the self-employed, the payment arrangements for NICs will continue to align with those for Income Tax (IT), wherever possible. But HMRC also want to consider opportunities for alignment beyond NICs and IT to reduce the burden on taxpayers, and make payment arrangements that are more like paying a single tax, for example being able to offset Construction Industry Scheme (CIS) deductions against other liabilities.

Smaller, more regular payments

For businesses and individuals, there are variable periods of time between the activity generating the tax liability and the payment date. These lags made sense in a paper-based world where it took time to gather the information to calculate liabilities. But in an increasingly digital world, taxpayers should not have to wait until after the end of their tax year or accounting period to understand how much tax is likely to be due, or to receive any repayments.

The government has already announced some changes in this area. The payment of Capital Gains Tax (CGT) on the disposal of residential property will be brought forward to within 30 days of completion and there will be a reduction to the filing and payment window for Stamp Duty Land Tax (SDLT).

We know from research and stakeholder engagement that many taxpayers see advantages from paying smaller amounts of tax more regularly. Research conducted for HMRC in 2015, for example, concluded that many small businesses saw that this could enable them to better plan their finances and avoid shocks, especially for taxes currently paid annually.

(https://www.gov.uk/government/publications/understanding-the-impact-of-reporting-cycles).

Some relevant quotes from the research are below:

"You pay your bills monthly why not tax? As long as it's not more expensive to do it that way" (Sole trader, SA)"

"It sounds like an attractive proposition. I wouldn't have drawers full of receipts! It would also save me from paying a huge tax bill at the end of the year" (Sole trader, SA)

"Having regular payments for HMRC will mean [it's] easier to balance the books and know where the business stands [for] finance" (10-49 employees, CT)

"Not knowing how much tax is due is difficult as I don't like shocks and it may mean I don't have the money available. Hence knowing if I'm over or under paying on a more regular basis will help, and it also helps cash flow" (2-9 employees, CT and VAT)

Example: Payment of Corporation Tax
Companies with profits above £1.5m a year are required to pay their Corporation Tax (CT) through Quarterly Instalment Payments (QIPs). Companies with profits below £1.5m a year make a single payment no later than 9 months and a day after the end of their accounting period. This means they pay tax later than is the case in any other country in the G20 and creates a significant transitional burden for those that grow and move onto QIPs.

Employees & Pensioners
The majority of employees and pensioners pay the correct amount of tax through their employer's operation of PAYE, but those with secondary income sources currently need to tell HMRC about this other income through the Self Assessment process.

Those employees and pensioners with secondary income of £10,000 or more a year from self-employment or property will be required to keep track of their affairs digitally and update HMRC at least quarterly through their digital account. Making Tax Digital will enable them to have a more up to date view of their overall tax position across all sources of income. The digital tax accounts will provide a view of how their personal allowances have been allocated against employments and pensions, the impact that has on the tax they pay each week or month and the tax owed on any income not covered by PAYE.

Employees and pensioners with secondary income of less than £10,000 will not be subject to the same requirements as business. But, they will be able to report income regularly through their digital tax account and HMRC will be able provide these taxpayers with the information they need to budget for tax on their income from self-employment and any other income they receive. In practice, digital accounts will mean these taxpayers, too, will be better able to keep their tax position up to date creating a straightforward bill (or repayment) closer to real time, removing the necessity of filling in a tax return or the worry of a surprise tax bill building up over the year.

Example: Individual with Employed and Self Employed Earnings

Individuals whose main income is through employment currently receive their pay after tax and national insurance has been deducted by their employer. In addition they have to complete a self-assessment tax return by 31 January, following the end of the tax year in which they received income from self-employment to provide HMRC with the information required to calculate the tax due.

In addition under the SA system the tax due for payment in January relates to income earned up to 20 months previously with a further payment on account potentially due in the following July. With payment dates set so long after the event this can feel like a disjointed and complicated process with little bearing on current circumstances.

Consultation events

HMRC wants to explore the issues raised in this document with stakeholders at an early stage and to invite their ideas. In particular, whether the principles that we have set out here of a simpler and more aligned payment system, operating in closer to real time are the right ones for a transformed tax system.

We are also interested in views on the practical steps involved in transitioning to any new payment arrangements, and the impacts on taxpayers.

We intend to begin this discussion with a series of events with key stakeholders in January and February, avoiding the immediate run up to 31 January wherever possible. If you wish to express an interest in joining one of the events, please email makingtaxdigital.mailbox@hmrc.gsi.gov.uk

NEST consults on changes to scheme rules

NEST (National Employment Savings Trust) has issued a consultation on proposed changes to its scheme rules, which bring aspects of the scheme into line with changes to pension legislation and take account of the lifting of the restrictions on contributions and transfers on NEST from April 2017.

Responses should be submitted by 21 March 2016.

NEST was set up by the government to make sure that every employer would have access to a high-quality workplace pension scheme for auto enrolment.

NEST's governing documentation comprises the NEST order and NEST rules. The NEST order sets out NEST's legal structure and gives the Trustee a number of powers, while the scheme rules provide further powers and more detail about how NEST works in practice.

The consultation covers various technical items pertaining to NEST's rules. These include:

- Updates to NEST's rules to allow lump sums and partial lump sums to be paid as benefits as provided for by the 'freedom and choice' changes introduced in April 2015.
- Changes which reflect amendments Parliament made to the NEST order in 2015 to lift NEST's restrictions on contributions and transfers from April 2017. NEST is now proposing to amend the rules to reflect those changes and complete the picture, in terms of Trustee powers, on transfers and the annual contribution limit.
- 'Tidying up' changes, for example to bring the rules into line with recent legislative changes such as the change to pension input periods.

The consultation runs from 20 January 2016 to 21 March 2016. Responses can be sent by email or by post, details for which are given in the consultation document.

New National Living Wage to give living standards boost to over a million workers

From 1 April 2016 workers in the UK aged over 25 earning the minimum rate of £6.70 per hour will see a 50p increase. The National Living Wage supports the government's vision of a higher wage, lower welfare, lower tax society. More than 70% of workers have said they will feel more positive for themselves and their families as a result of the introduction of the new National Living Wage, announced by the Chancellor at the Summer Budget.
The findings are part of a new government survey which also shows that 59% of respondents will feel more motivated at work as a result of the increase in their pay packets.

Over a million workers in the UK aged 25 and over are set to directly benefit from the increase, which sees the current minimum rate of £6.70 increase by 50p. Many will see their pay packets rise by up to £900 a year. This will be the largest annual increase in a minimum wage rate across any G7country since 2009 in cash and real terms.

The survey results coincide with the launch of a new advertising campaign based around real people talking about the positive effect the new National Living Wage will have on their lives.

The advert, due to launch on Monday 18 January 2016, will feature a range of workers from across the UK set to benefit from the National Living Wage as it increases over the next 4 years.

Chancellor George Osborne said:

> The new National Living Wage is an essential part of building the higher wage, lower welfare, lower tax society that Britain needs and it's great to see that over a million people will see their living standards boosted when this comes into force on 1st April.
>
> Britain deserves a pay rise and this one-nation government is making sure it gets one, helping more people have the security of a higher wage to provide for themselves and their families.

Business Secretary Sajid Javid said:

> The government believes that Britain deserves a pay rise and our new National Living Wage will give a direct boost to over a million people. We are building a more productive Britain and giving families the security of well-paid work.
>
> This is a step up for working people, so it is important workers know their rights and that employers pay the new £7.20 from April 1 this year.

Rena Matthew, who appeared in the TV advert, earns £7 per hour as a social services family contact officer in West London. The mother of 2 welcomed the income boost:

> I think it's a great idea. There are a lot of people who are struggling to meet financial needs. To have this extra support and get a good wage is really important to them.

The National Living Wage will give people a little more confidence and motivation to work.

The campaign will highlight the new wage and tell people to find out more by visiting the website: livingwage.gov.uk.

The move will support hard working families across the country. They will also benefit from an increase in the personal allowance, taking the lowest paid out of tax, while free childcare will increase to 30 hours, helping household budgets stretch further.

Many UK companies have already pledged to pay at or above the new rate, including Morrisons, Lidl, National Express and Ikea.

The government is continuing to raise awareness to businesses to make sure they are ready to pay the new wage on 1 April 2016. As part of this, it has published a four-step guide for businesses on the living wage website, asking firms to:

1. Check you know who is eligible in your organisation.
2. Take the appropriate payroll action.
3. Let your staff know about their new pay rate.
4. Check your staff under 25 are earning at least the right rate of National Minimum Wage.

HMRC will have responsibility for enforcing the new National Living Wage in addition to the National Minimum Wage from April 2016 and will take firm action where an employer fails to pay the correct wage.

For light relief….HMRC reveals Top 10 worst tax return excuses for 2014

As the Self Assessment deadline approaches on 31 January, HMRC reveals some of the worst excuses submitted last year for late tax returns.

The ten worst excuses for missing the 31 January Self Assessment deadline for 2013 to 14 have been revealed by HM Revenue and Customs (HMRC).

From broken kitchen appliances, hungry pets and arguments that last five years – some people will stop at nothing to pass the blame for their tardy timekeeping. Some of the excuses submitted included:

1. My tax papers were left in the shed and the rat ate them
2. I'm not a paperwork orientated person – I always relied on my sister to complete my returns but we have now fallen out
3. My accountant has been ill
4. My dog ate my tax return
5. I will be abroad on deadline day with no internet access so will be unable to file
6. My laptop broke, so did my washing machine
7. My niece had moved in – she made the house so untidy I could not find my log in details to complete my return online
8. My husband ran over my laptop
9. I had an argument with my wife and went to Italy for 5 years
10. I had a cold which took a long time to go

The excuses were all used in unsuccessful appeals against HMRC penalties for late returns.

While HMRC will not accept spurious excuses when the vast majority hit the deadline and pay up what they owe, we do recognise that a number of taxpayers may have difficulties completing their tax return on time. For instance, those affected by flooding at their premises, or their agents' premises, will not be asked to pay a penalty if their return is submitted without unreasonable delay. The department has also opened a Tax Helpline to give practical help and advice to people affected by severe weather and flooding – 0800 904 7900.

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

> Untidy family members and hungry pets are very unlikely to be accepted as a legitimate excuse for completing your tax return late.
>
> We understand that life can be unpredictable and for those customers who have a genuine excuse for missing the 31 January deadline, such as the flooding, help is on hand. My advice would be to contact us through our helplines or online, as soon as possible. But for those who are trying to play the system, while the rest of us do the right thing, the message is clear: submit your tax return online by 31 January or face a fine. We're here to help people in genuine distress, but not to act as a free lender to people who can't meet their responsibilities to pay their tax.

The deadline for sending 2014-15 tax returns to HMRC, and paying any tax owed, is 31 January 2016.

Business Taxation

What date did the trade start and was it commercial?

Summary – The Tribunal found in the taxpayer's favour on the start of a trade but only in respect of the second years it was seen as commercial by then

The taxpayer set up a tree surgery and woodmanship business and registered self-employed with HMRC in November 2010. He was also employed by the Royal Navy until he was made redundant in late 2011.

In his 2010/11 and 2011/12 tax returns, he included expenses relating to his self-employment and deductions for annual investment allowance. His turnover for each year was nil, so he claimed the losses against other income.

HMRC disallowed the claims on the basis that the taxpayer's trade was not commercial. The taxpayer appealed.

Decision:

The First-tier Tribunal said a trade did not have to result in payment of money. Services could be provided in return for a benefit. However, just because a particular piece of work was capable of being a trading activity, did not make it a trade. Someone who owned a chainsaw and did occasional work for a neighbour in return for wood could not on that basis alone be described as a trader.

However, taking into consideration the badges of trade (*Marson v Morton* [1986] STC 463), the tribunal accepted that the taxpayer was trading. Further, in November 2010, he acquired and distributed business cards and had begun to look for work for which he would be rewarded. He dealt with third parties and put money at risk by buying advertising material and tools. The tribunal said his trade began therefore in November 2010.

On commerciality, the tribunal said there was no reasonable expectation that in 2010/11 the trade could produce a profit. Therefore, losses for that year could not be set against other income. By 2011/12, the taxpayer was acting in an organised and business-like way. He obtained assignments and looked for jobs for which he would be paid. This seemed to be trading commercially, with an expectation of profits in later years. Losses for the year could be set off against other income under s66 ITA 2007.

The taxpayer's appeal against the 2010/11 assessment was dismissed, but the one against 2011/12 was allowed.

Comments – Although the case looks predominantly at losses in early years it also looks at the start of a trade and when it begins. It is good to have another case involving the issues of whether there is a trade and if there is when does it commence. This case may well join the often quoted cases on the badges of trade.

K Johnson v HMRC TC4805

Doctor's travel expenses between his home and hospitals disallowed

Summary – The FTT determined that travelling and subsistence expenses of a doctor were not deductible.

The taxpayer, a consultant orthopaedic surgeon, was employed by his local NHS trust in Kent and had a private practice at another hospital. He also provided medical reports for litigation purposes under contract for several agencies. He had to visit clients to prepare the reports and carried out these consultations once a month at The Spire in Washington, Tyne and Wear, and the BMI Manor in Bedford.

He claimed travel and subsistence expenses against his earnings from the report work and accounted for the income using the receipts basis. HMRC refused the expenses claim and said the earnings should be reported by reference to the date when an invoice was issued rather than the date payment was received. This was because the payment was earned when the taxpayer completed his task.

The taxpayer appealed.

Decision:

Looking first at the accounting issue, the First-tier Tribunal said there were two occasions when the taxpayer could be said to have completed the preparation of each report. For those where no further questions were raised, this was the date when the invoice was submitted; for those where further questions were raised, it was the date the supplementary invoice was submitted. It followed that these were the dates when the taxpayer's earnings should be accounted for.

On travel expenses, the tribunal found that the taxpayer's home was a place of business for the medical report business, but The Spire and the BMI Manor were also his places of business. Therefore, the costs of travel between them and his home, even though that too was a place of business, were not incurred wholly and exclusively for the purposes of the business and were not deductible under ITTOIA 2005, s 34.

The subsistence costs were also not deductible because they had the dual purpose of providing nourishment.

The taxpayer's appeal was dismissed.

Comments - This case is another example of how the principles which were set out in the *Samadian* case are likely to be applied. Obviously cases on similar facts should be treated in a similar fashion. It highlights that practitioners need to consider carefully in light of recent cases the detailed treatment of self-employed clients' travel and subsistence.

Dr S Jain v HMRC TC4788

Tax avoidance main purpose of LR arrangement – Scheme fails

Summary – The Tribunal held that the loan relationship unallowable purpose rules applied to diallow debits arising with regard to a fair value loss on a deemed loan relationship in connection with a tax avoidance scheme

The taxpayers took part in a tax avoidance scheme that was notified to HMRC under the disclosure of tax avoidance schemes rules in Part 7 FA 2004. In essence, the scheme involved bringing a holding of a subsidiary's shares within the loan relationship rules by entering into a derivative contract called a “total return swap”. It then depressed the value of the shares by novating a large loan liability into the subsidiary from another group company.

The aim was to accrue a large loan relationship debit in the shareholding company by reference to the reduction in the fair value of the shares in its subsidiary. As a result, the subsidiary company also accrued conventional loan relationship debits because of its liability to interest on the loans novated to it.

HMRC disallowed the large debit in the shareholding company and the smaller debits in the subsidiary on the basis of the “unallowable purpose” rule in para 13 Sch 9 FA 1996.

Decision:

The First-tier Tribunal found that the purpose of the shareholding company when entering into a swap while holding shares in its subsidiary had been to avoid tax as, indeed, the taxpayers acknowledged. Paragraph 13 therefore applied to disallow the debits attributable to the disallowable purpose. Further, the purpose of the subsidiary in entering the arrangements had been to secure a tax advantage for its parent. This was also an unallowable purpose and the resulting debits should be disallowed.

The taxpayers' appeal was dismissed.

Comments - This judgment represents another taxpayer defeat in a line of tax avoidance schemes designed to exploit aspects of the loan relationship rules. 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. 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

Was a residential property owned by a pension scheme taxable?

Summary – The FTT allowed an appeal against an unauthorised payment, scheme chargeable payment and sanction charges in relation to a pension fund

The company ran a small self-administered occupational pension scheme, registered with HMRC. The scheme owned the yard, part of the business premises of the company. It also bought a property in October 2006 in which foreign employees were able to live under the terms of their employment.

HMRC said the fund had an interest in a residential property that was taxable under FA 2004, s 174A (for more information, see HMRC's *Pensions Tax Manual* at PTM125000).

Some types of property are excluded under Sch 29A para 10; in this case the issue turned on conditions A and B in para 10(2) and (3) respectively.

The taxpayer argued that the property was not taxable because it was a condition of employment that the employees lived there (para 10(2)(c)). Alternatively, condition B applied because the property was used in connection with the business premises held as an investment in the pension fund.

Decision:

The First-tier Tribunal said that the employment contract did not require employees to live in the property and therefore it could not be described as a condition of employment. Condition A was not satisfied.

The judge agreed with the taxpayer that condition B was satisfied. He said the use of the property as accommodation for the foreign employees working in the yard was a "sufficient connection" for the purposes of para 10(3)(b). It was bought for that reason and used only by such employees. The arrangements were not artificial and there was a direct connection between the property and the yard.

The taxpayer's appeal was allowed.

Comments – The Tribunal considered both both the statutory purpose referred to in the Technical Note on the proposed legislation that enacted Sch 29A and the more restrictive wording of the previous legislation from which Condition B was derived and found that both supported their wider interpretation of the existing Condition B.

J&A Young (Leicester) Ltd and others v HMRC TC4771

Farming losses made in five successive years

Summary – The Tribunal found that the taxpayer had made losses in each of the years and therefore the provisions preventing the loss relief applied

The taxpayer reported losses from his farming business in the years 2002/03 to 2012/13. Apart from 2007/08, he set off each year's loss against other income in the same year.

For 2007/08, he entered the loss in the box “total loss to carry forward after all other set-offs”. However, he did not complete the box “loss brought forward from earlier years” in later returns. As a result, he never claimed relief for the 2007/08 losses.

In April 2014 HMRC opened an enquiry into the taxpayer's 2012/13 return. They disallowed the loss relief for that year, and also for 2010/11 and 2011/12.

Under ITA 2007, s 67 relief is not allowed if a loss was made in a farming business in each of the previous five years. The taxpayer said that, instead of claiming the 2007/08 loss — this being the fifth successive year one was made — he voluntarily adjusted the amount to zero. He said that s 64 permitted this because it states that losses “may” be claimed as opposed to “must” be claimed. As a result, it was not the case that for 2010/11 to 2012/13 the taxpayer had a loss calculated in each of the previous five years.

HMRC disagreed, saying a loss need only be made in each of the previous five years; it did not have to be claimed. The loss referred to in s 67(2) referred to that in s 67(1). This expressly applies when a loss is “made in a trade of farming”. The year 2007/08 was the fifth one in succession in which losses were made. Therefore, in every subsequent tax year, the taxpayer had made a loss in each of the previous five tax years.

In any event, the taxpayer included a loss in the carry forward box of his 2007/08 tax return. This was a calculation of a loss for income tax purposes, regardless of whether it was claimed in the next return. They disallowed the loss relief claimed for 2010/11 and 2011/12 on the basis that he was not entitled to claim it.

Decision:

The First-tier Tribunal preferred HMRC's view. The judge said s 67(2) applied to trade losses made in each of the five previous years and did not depend on the loss being claimed. The taxpayer's 2007/08 return included the loss so it had been calculated. Not claiming it did not mean the loss was “recalculated” to zero.

The taxpayer's appeal was dismissed.

Comments – It was a nice try to create an argument to manipulate the wording of the legislation so that the loss was not claimed and therefore did not exist in theory. The Tribunal saw through the argument as the losses factually had occurred irrespective of whether a claim had been made in respect of them.

W Donaldson v HMRC TC4779

Use of losses outside the four-year time limit

Summary – The FTT allowed the appeal against HMRC assessments that denied the company relief for brought forward trading losses on the basis that the earlier period's losses did not exist because they had not been established by an in-time self-assessment in respect of the loss-making periods

The taxpayer was a German-incorporated, wholly owned subsidiary of B, a UK publishing company. It became UK resident after it was acquired by B in 2003 after which it was subject to corporation tax. It was unaware of its change of residence until 2010 when its adviser submitted an error or mistake claim under FA 1998, Sch 18 para 51. It filed tax returns for the periods 2004 to 2009 and a voluntary return for 2003. The company recorded losses for 2003 and 2004 which it claimed to set against future profits.

HMRC agreed that the company had become UK resident in 2003 but the losses could not be claimed because the returns for 2003 and 2004 were out of time. In essence, the Revenue said the losses did not exist because the company was out of time to self-assess for those years.

Decision:

For the 2003 period, the First-tier Tribunal said the company's voluntary return was not a company tax return because it was not required by Sch 18. However, HMRC required a return for 2004 and the company filed it within the time allowed. The 2004 losses could therefore be set against the taxpayer's profits in later years.

Finally, the tribunal said nothing prevented the 2003 losses being set off in 2005 because relief under TA 1988, s 393 was allowed as part of the computation of trading losses for the year. The fact that they related to a year for which HMRC did not require a return did not prevent it establishing the existence of losses and their availability for set-off.

The taxpayer's appeal was allowed.

Comments – The case provides a useful analysis of the provisions of Sch 18 FA 1998 dealing a company's obligations under CTSA in addition to the automatic offset of brought forward losses under s393(1) of ICTA 1988. The FTT found that HMRC had not required a return for the first loss making period and there was nothing to prevent a loss in that period from being offset in a later period. The return for second loss making period was not out of time. The four year time limit only applies to HMRC assessments and not to self-assessments. Therefore the losses for both years were avaialable for carry forward and offset in later periods.

Bloomsbury Verlag GmbH v HMRC TC4778

Not all payments to workers were within the CIS

Summary – The Tribunal found partially in favour of the taxpayer as not all of the payments were made in the capacity of a contractor

The taxpayer was a bathroom fitter. Between 2010 and 2013, he paid individuals for construction work they had done on sites where he was working. HMRC said the taxpayer should have operated the construction industry scheme on the payments.

Decision:

The First-tier Tribunal found that, in some cases, the taxpayer was paid by his client as trustee or agent, not as a person obliged to render services or procure the rendering of services.

The workers were, in those instances, working for the client rather than the taxpayer (FA 2004, s 58). They were therefore not subcontractors and the payments did not fall within the construction industry scheme.

However, the tribunal decided that in other cases, the scheme should apply because there was a contractual relationship between the taxpayer and the subcontractor.

In the latter cases, the tribunal ruled that the taxpayer did not have a reasonable excuse for failing to operate the scheme. The judge accepted the taxpayer was not an educated man and had difficulties reading, but said ignorance of the law was no excuse.

The taxpayer's appeal was allowed in part.

Comments – The FTT found that the taxpayer's reliance on his accountant did not amount to a reasonable excuse in respect of the CIS late filing penalties because there was no evidence that he had specifically instructed his accountant to undertake all reporting obligations. The FTT could not say that the taxpayer took reasonable care to avoid any failure to comply with his CIS duties.

David Crossman v HMRC TC4811

Deduction of Income Tax at source from payments of peer-to-peer interest

Purpose of Revenue and Customs Brief 2/2016
This brief sets out HM Revenue & Customs' (HMRC's) current position on the obligation to deduct Income Tax at source on interest that is paid on peer-to-peer (P2P) loans.

Readership
Anyone making payments, or acting as an intermediary for payments, in whatever form, on P2P loans including:

- P2P lending platforms
- anyone who lends money using P2P platforms
- anyone who borrows money using P2P platforms

- anyone who acts as an intermediary for payments made on P2P loans

P2P loans
The P2P lending sector enables individuals and businesses to lend to each other through the intermediary of an internet platform. It provides new opportunities for investors and new sources of finance for borrowers.

P2P lending operates on a 'many to many' lending model where the platform acts as an intermediary to arrange and manage the loans. The platforms put lenders with money in touch with borrowers. The idea is that both the lender and borrower benefit from better rates than they could get from a bank. A borrower will borrow small amounts from many lenders to make up the full the loan that they need, and lenders will place money with the platform that is then lent out to many different borrowers in many small sub loans.
Background
Under existing tax rules in Chapter 3 of Part 15 of the Income Tax Act 2007 there is a requirement to deduct Income Tax from certain payments of yearly interest (broadly, interest on a debt of more than 12 months duration).

Issue
Whether tax must be deducted from a payment will depend on the identity of both the lender and the borrower of the loan. The many-to-many lending model used by the P2P industry means that the application of these rules is very complex for loans made through P2P platforms and leads to inconsistent tax treatment.

Current position
The government is in the process of changing the obligation to deduct tax from interest paid on P2P loans. A consultation took place over the summer of 2015 and the legislation will be amended to clarify how any obligations will apply in the future. Further information about this will be released as it is available.

Interim treatment
The costs to the platforms of developing the necessary systems to apply the current rules in the meantime would be disproportionate to the relatively small amount of tax which would be collected. Consequently, in the period before the government makes any necessary changes to the legislation, interest payments made on P2P loans may be made without deduction of tax.

This will apply to interest payments made by:
- a UK borrower to a UK P2P platform
- a UK P2P platform whoever made to
- any intermediary to or from a UK P2P platform

In each case the P2P platform must be authorised by the Financial Conduct Authority (including interim authorisation).

What this means for the lender

The interest that a UK lender receives from P2P loans is taxable in the same way as any other payment of interest. This means that if a person receives interest without deduction of tax, it is their responsibility to notify HMRC of the income and to pay the correct amount of tax due.

Future implications

The tax treatments outlined in this brief are for the purpose of deduction of tax under Chapter 3 of Part 15 of the Income Tax Act 2007 only. They do not affect the treatment of either the loan or the interest for regulatory, taxation (other than the deduction of tax at source) or other purposes. Once the legislation has been amended HMRC will issue further guidance as appropriate.

Farmer loses loss relief appeal (Lecture B936 – 17.26 minutes)

Late last year, a very interesting decision was reached in the First-Tier Tribunal case of Silvester v HMRC (2015), disallowing the taxpayer's sideways loss relief claims under S64 ITA 2007 for 2008/09 and 2009/10.

The case

The taxpayer (S) was an experienced sheep farmer and a member of the National Sheep Association. He was a partner in a farming partnership which owned and operated one of the largest sheep farms in Cornwall. For many years, S had been a successful businessman outside farming and it was only on his retirement that he had taken up sheep farming. S had a substantial pension income and it was against this that he sought to claim relief for his share of the losses suffered by the farming partnership.

The partnership had initially tried to produce pure-bred animals, but, following a small profit in the year ended 30 June 2000, the subsequent years all showed losses before any capital allowances claims. In 2005, the partners concluded that their attempt to breed pure stock was not working and so they changed their business model to the breeding of lambs for the meat market which involved the acquisition of different breeds of ewes and rams. However, further problems followed including the theft of 100 lambs in each of two successive years, as a result of which it was not until after 2010 that the partnership business again became profitable.

Sideways relief

It will be remembered that S64 ITA 2007 allows a person to make a claim for loss relief against his total income for the tax year in which the loss is made and/or for the previous tax year. S66 ITA 2007 precludes a sideways loss relief claim if the trade is not conducted on a commercial basis and with a view to the realisation of profits. This latter provision applies to losses arising in any type of trade, and not just farming. HMRC did not rely on S66 ITA 2007 in this case.

Restriction on relief for "hobby" farming or market gardening'

Ss67 – 70 ITA 2007 are headed 'Restriction on relief for "hobby" farming or market gardening'. S67 ITA 2007 is the provision that HMRC used to challenge S's loss claims. This section only applies to losses arising in farming and market gardening trades. S67(2) ITA 2007 confirms that sideways loss relief is not available where there has been a trading loss (calculated on an April-to-April basis and without regard to capital allowances) in each of the previous five tax years. S's run of trading losses started with 2000/01. S67(3) ITA 2007 provides three let-outs from this rule, of which the only one relevant to S was S67(3)(b)

ITA 2007 – this states that the farming activities must meet the 'reasonable expectation of profit' test in S68 ITA 2007 if sideways loss relief is to be available.

Reasonable expectation of profit

S68 ITA 2007 explains how farming activities can meet the 'reasonable expectation of profit' test. The key provision for the purposes of this case is whether a competent farmer carrying on the activities at the beginning of the period of losses, ie. on 1 July 2000, could not reasonably have expected the activities to become profitable until after the end of the tax years in question (2008/09 and 2009/10). S's appeal to the First-Tier Tribunal ultimately turned on whether the partnership satisfied this condition.

The arguments

S's first argument was that, since the rubric to Ss67 – 70 ITA 2007 refers to 'hobby' farming and since he was clearly not a 'hobby' farmer (given that he operated on a proper commercial basis), S67 ITA 2007 had no relevance to him. However, the First-Tier Tribunal decided that S67 ITA 2007 did apply to S's farming activities. The heading to the sections can be seen as an aid to their construction, but it cannot govern the language actually used in any of the provisions. As such, each word must be given its ordinary meaning. S67 ITA 2007 was not therefore restricted to 'hobby' farming, but could apply more generally to all farming activities. This view was supported by another recent First-Tier Tribunal decision (French and French v HMRC (2014)).

Having lost the argument in (g) above, S was hoping to fall back on the fact that he nevertheless met the 'reasonable expectation of profit' test as outlined by S68 ITA 2007. However, the First-Tier Tribunal did not consider it reasonable that a competent farmer carrying on sheep farming activities in 2000 would not have expected it to move into profit until 2009/10 or 2010/11 (ie. the tax years immediately after the tax years for which the losses in question were being claimed). As they pointed out:

'That would require S to have predicted unforeseeable events such as the foot-and-mouth outbreak and two episodes of lamb rustling.'

They went on:

'Had S, in July 2000, expected the activities to be loss-making for the next nine or 10 years, we have no doubt that he would have changed the business model with a view to making it profitable, as he did in 2005 when he accepted that the existing business was unlikely to become profitable. From that, we infer that, in July 2000, S, and thus the competent farmer for whom he is a proxy, could not reasonably have expected (and did not expect) that the sheep farming activities would not make a profit until 2009/10 or 2010/11.'

Accordingly, they concluded that S did not meet the 'reasonable expectation of profit' test in S68(3)(b) ITA 2007 and so his sideways loss relief claims were denied.

Contributed by Robert Jamieson

Restriction to corporate interest tax relief (Lecture B937 – 13.11 minutes)

On 22 October 2015, HM Treasury published a consultation paper on the Government's plans to restrict the tax-deductibility of corporate debt costs.

The aim, according to HM Treasury, is to counter 'aggressive' tax avoidance, especially by large companies using cross-border debts to shift taxable profits between jurisdictions. Typically, this is achieved in one of three ways:

1. by placing higher levels of third-party debt in high-tax countries;

2. by using intra-group loans to generate interest deductions which are higher than the group's actual third-party interest expense; or

3. by using third-party or intra-group financing to fund the generation of tax-exempt income.

The idea for a restriction on debt relief has been inspired by the OECD's Base Erosion Profit Shifting (BEPS) initiative. Most OECD countries allow interest expense to be deducted in calculating taxable business profits, but many jurisdictions also have rules to protect them against misuse. Currently, the UK has two main protection mechanisms:

1. Transfer pricing provision that restricts tax relief for interest paid to an arm's length amount, although it should be noted that there is no check on whether the income or assets supporting that interest are themselves taxable.
2. Worldwide debt cap which acts as a backstop for excessive interest deductions.

There are also a number of TAARs to supplement the arm's length test referred to in (i) above.

Despite this, the consultation paper admits that 'significant planning opportunities can arise from both external and intra-group interest expenses'. Although a number of countries such as Australia, Germany, Italy, Japan and Spain already have rules which provide what the consultation paper calls 'a structural restriction on tax relief for interest expense', HM Treasury acknowledge that a general provision which restricted interest would represent a major change to the UK corporate tax regime, requiring 'careful consideration to ensure (that) any new rules work appropriately'.

Any such rule is likely to mirror the OECD's BEPS proposal, namely that a corporate group's net interest relief should be capped at a fixed percentage of its taxable UK profits. This percentage cap will be set somewhere between 10% and 30% and will be applied to the EBITDA measure of profits, ie. earnings before interest, taxes, depreciation and amortisation. In the UK, for 'depreciation' read 'capital allowances'.

The consultation closed on 14 January 2016, but any changes are unlikely to be introduced before 1 April 2017 at the earliest.

Contributed by Robert Jamieson

VAT

Was there a single or a multiple supply?

Summary – The Tribunal determined that there was a principal supply and an ancilliary supply

The taxpayer was a second-hand car dealer. He took the view that if he agreed with a customer that he would obtain a fresh MOT certificate before the sale, its cost should be treated as a disbursement in the operation of the margin scheme.

HMRC disagreed. They said, because the supply represented the sale of a car with an MOT certificate, there was a single rather than multiple supply. The taxpayer appealed.

Decision:

The First-tier Tribunal accepted that the question of obtaining a new MOT certificate always took place before the deal was made and that its cost formed part of the overall price. However, the judge said, “in substance and reality” this comprised one supply or a principal supply and an ancillary one. The cost could not be regarded as a disbursement and it would be “wholly artificial to distinguish between the supply of the motor car and the supply of the fresh MOT certificate”.

However, the judge reduced the officer's assessment to take into account that only 30% of cars sold with a warranty had a fresh certificate purchased rather than 100% as the officer had assumed. The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, noted: “As a general principle, there would be no problem treating the MOT charge to the customer as a disbursement if the request for a fresh certificate had come after the sale had taken place. It would have then been an extra sale separate from the main supply of the car. The additional payment would have qualified as a disbursement and excluded from the margin calculations.”

R L Finney v HMRC TC4667

Output tax on supplies of restaurant and entertainment by a college

Summary - The Court of Appeal referred the case to the ECJ for a ruling on whether the College’s supplies of catering in its restaurant and its supplies of concerts and performances were “closely related” to its supply of education and therefore exempt

The taxpayer ran courses in catering and performing arts. It had a restaurant in which all the catering functions were carried out by students to enable them to learn the skills in a practical environment. The public could eat in the restaurant and were charged about 80% of the cost of the meal. Similarly, performing arts students staged shows in the college which the public could attend.

The college claimed a repayment of output tax for the supplies of restaurant and entertainment services on the basis that they were covered by the education exemption in VATA 1994, Sch 9 group 6 (pursuant to article 132(1)(i) of the Principal VAT Directive). HMRC disagreed, saying the supplies should be standard rated.

The First-tier Tribunal held that they were exempt and the Upper Tribunal (Tax and Chancery Chamber) upheld that decision. The Revenue appealed.

The parties wrote to the Court of Appeal stating that they agreed that the matter should be referred to the Court of Justice of the EU for a preliminary ruling.

Decision:

The court agreed. The judge said, in the absence of any direct authority, the interpretation and application of the exemption in this case were not clear. He added that the facts were not unusual so the decision could have a wide impact.

Comments – The ruling from the ECJ should in time should help to clarify the scope of exemption for certain supplies of education.

CRC v Brockenhurst College, Court of Appeal

Is the option to buy in lease a supply of goods or services?

Summary – The Court of Appeal decided to seek further guidance from the ECJ on the correct interpretation and application of art 14(2)(b) of the 2006 VAT directive concerning the meaning of the "supply of goods"

The taxpayer entered into motor vehicle finance agreements with customers, who received the use of a car in return for monthly payments and could choose to buy the vehicle at the end of the term.

HMRC said each agreement was a supply of goods. They issued VAT assessments on the basis the tax was chargeable on the full cost of the car when the agreement was made. The taxpayer argued that the arrangement was a supply of services and VAT was chargeable on each monthly payment.

The First-tier Tribunal dismissed the taxpayer's appeal but the Upper Tribunal said the lower chamber had made an error of law in its interpretation of article 14(2)(b) of EU Directive 2006/112/EC (supply of goods). The Upper Tribunal judge decided the agreement could not be characterised as a contract for the sale of a vehicle and allowed the taxpayer's appeal. The judge declined to refer the interpretation of article 14(2)(b) to the Court of Justice of the European Union (CJEU).

HMRC appealed.

Decision:

Lord Justice Patten in the Court of Appeal said the Upper Tribunal should have referred the matter to the CJEU. There was no direct guidance about the interpretation of article 14(2)(b). Although it referred to what a contract of hire provided, it was not clear whether the phrase “in the normal course of events” required a tax authority to identify the existence of an option that was not exercisable later than on payment of the final instalment or to go further and determine the economic purpose of the arrangement.

The judge ruled that the issue should be referred to the CJEU for it to decide the correct interpretation and application of article 14(2)(b).

Comments – The difference or distinction in the type contract examined in this case between a supply being one of goods or one of services is significant for VAT in that the supply of goods is taxable at the beginning whereas the supply of services is taxable when the payments are received during the course of the contract. As the point has not been previously considered in the ECJ the Court of Appeal decided to seek a preliminary ruling from the ECJ.

CRC v Mercedes-Benz Financial Services UK Ltd, Court of Appeal

Input tax claimed on invalid tax invoices

Summary – The Tribunal found that HMRC’s decision to deny input tax recovery was reasonable

HMRC disallowed £10,063 of input tax claimed by a bakery business on its first VAT return to June 2014. The sum related to fees charged by R for managing the company payroll and by another company, F, for taking over the contracts of employees.

HMRC refused the claim on the basis that the VAT registration number quoted by F belonged to another business and that R was not VAT registered. The taxpayer said it had carried out verification checks using the Companies House and Europa websites. However, HMRC were not satisfied that the business “had taken reasonable steps to ensure the credibility of the supplier, given that the identity of the supplier was not obviously apparent from the invoices and R was registered for VAT”.

Decision:

The First-tier Tribunal noted the problems faced by small businesses in dealing with VAT but said HMRC's decision to deny input tax recovery was reasonable. The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, noted: “Regulation 29(2) of the 1995 VAT Regulations gives HMRC the power to accept alternative evidence to support an input tax claim in the absence of a valid tax invoice. They should also allow a claim where the taxpayer has taken reasonable steps to ensure a supplier is VAT-registered and is therefore entitled to charge VAT. It would seem that the paperwork issued by R contained some obvious indicators that the company was not VAT-registered. The taxpayer should have been able to identify this as a problem when it checked the Europa website.”

Ambrosia Bakes Ltd v HMRC TC4694

Value of self-supply made by a car manufacturer

Summary – The Upper Tribunal confirmed the FTT's decision that the transfer price of vehicles imported from its sister company was the appropriate measure for VAT purposes of the deemed consideration

Between 1987 and 1996 the taxpayer accounted for VAT on the basis that, when it used one of its own cars that it had manufactured or imported, it had made a deemed self-supply. VAT was chargeable on two-thirds of the retail list price of each vehicle. It later submitted a repayment claim on the basis that it should have accounted for VAT on a lower amount.

HMRC rejected the claim.

The First-tier Tribunal allowed the taxpayer's appeal. HMRC appealed to the Upper Tribunal.

Decision:

The first issue for the tribunal was whether the taxpayer could rely on the price of imported vehicles as an alternative measure of the price of UK-manufactured cars from 1992. HMRC said that a car imported from a sister company could not be regarded as identical to the same model manufactured in the UK. The judge disagreed saying that the imported cars should be regarded as identical to their UK counterparts.

HMRC contended that the First-tier Tribunal had erred in law by providing a solution rather than determining whether the claim had been established on a balance of probabilities. The judge said the First-tier Tribunal had to ascertain the amount of overpaid VAT; its preferred solution did not have to be one for which either party had contended.

Further, the First-tier Tribunal had been entitled to rely on particular disputed documents. Finally, the judge said it was entitled to accept a model-based approach to the question of the cost of manufacturing cars in the UK. He repeated that the tribunal's "overriding duty was to ascertain … the true amount of VAT due … drawing … on their own experience and expertise". It was reasonable for this to involve an element of subjectivity.

HMRC's appeal was dismissed.

Comments – The FTT allowed the appeal to the extent that the two-thirds proxy exceeded the 'cost' or 'purchase price' of the cars. The UT upheld the FTT's findings that the 'transfer price' paid for cars imported from GMUK's sister company was the appropriate measure of the deemed consideration for the self-supply where based on 'price' and rejected HMRC's arguments that the FTT's approach to determining the 'cost' of cars manufactured in the UK (where cost was an available alternative measure of the deemed consideration) and the evidence it relied upon in doing so amounted to an error in law.

CRC v General Motors (UK) Ltd, Upper Tribunal

Input tax on legal fees

Summary - The FTT dismissed the appeal against HMRC's decision to disallow a claim to recover VAT charged on legal services incurred by a property investment company on legal fees for the defence of its sole director

The appeal related to input tax incurred on legal services for the defence of Substantia's owner and sole director against criminal charges of false accounting. HMRC had rejected the repayment claim on the grounds that Substantia was not carrying on a taxable business and that there was no direct and immediate link between the reclaimed input tax and supplies made by it.

Decision:

The FTT observed that for input tax to be recoverable, the goods or services must not simply benefit the business but must be used for the purpose of the business. A 'direct and immediate link' was necessarily required.

The FTT determined that Substantia was not entitled to input tax recovery. The legal services provided primarily served its director's personal interests, although preserving his reputation and his liberty were definitely of benefit to Substantia.

The FTT found, however, that Substantia had been involved in taxable activities. Although there had been a significant delay in securing income from a property development, the business had been carried out diligently.

Comments - The relevant test is that the services must not simply benefit the business, but must be used for the purpose of the business. The purpose test is subjective and protecting a business' reputation and prospects can be a relevant business purpose, but the FTT is usually cautious in applying the test. There must be a clear link; for instance, where an employee is charged because of what he did in his employment.

Substantia Invest v HMRC TC 4789

VAT on car parking charges

Summary - The Court of Appeal upheld the Upper Tribunal's finding that the non-taxation of off-street car parking (OSCP) to local authorities would lead to significant distortions of competition.

This appeal was taken by four local authorities as the lead case in determining whether the charges made by a local authority for off-street car parking ('OSCP') were standard-rated. The appellants had lodged claims under the VATA 1994, s80 for repayment of VAT accounted for on OSCP between 1997 and 2001, HMRC had rejected claims. Many other local authorities had submitted similar claims. The case follows much earlier litigation, starting in 2004, including reference of questions to the ECJ in 2007. The burden was on HMRC to establish that non-taxation of OSCP would cause distortion of competition.

The issue was whether a local authority which charges members of the public for OSCP is a non-taxable person for VAT purposes. This turned on whether treating the authority as a non-taxable person 'would lead to significant distortions of competition' under the Sixth VAT Directive art 4.5(2) (replaced by the Principal VAT Directive art 13).

The interpretation of the provision had been referred to the CJEU, which had found that:

- the significant distortions of competition must be evaluated by reference to the activity in question, without reference to any local market in particular;
- the prohibition concerns not only actual competition, but also potential competition, provided that the possibility of a private operator entering the relevant market is real and not purely hypothetical; and
- the word 'significant' means that the actual or potential distortions of competition must be more than negligible.

On remittance of the case back to the UK courts, both the UT and the FTT had found that the non-taxation of OSCP by local authorities would distort competition.

Decision:

The Court of Appeal commented that when local authorities fix OSCP charges so as to give effect to traffic management, planning, economic and environmental objectives, it is entirely lawful and correct of them to take into account the overall constraints of meeting the cost of providing OSCP (except that they can charge more than cost for some specific relevant policy objectives). As a result, the absence of any liability of local authorities to pay VAT on OSCP charges would permit local authorities to meet the cost of providing OSCP while charging less to those using that facility.

The Court of Appeal accepted the finding of the FTT that the downward pressure on OSCP charges — resulting from the wish of local authorities to contribute to the economic vitality of their areas through charging that does not deter shoppers, and the unpopularity of car parking charges — would have caused charges to be set at a lower level than in circumstances of taxation by a margin approaching the VAT fraction. Non-taxation by local authorities would therefore lead to significant distortion of competition.

Comments - This case is the latest episode in the long running litigation, which started in 2004, involving many local authorities claims for VAT repayment of VAT paid on OSCP charges. It remains to be seen whether this is the end of the litigation.

Isle of Wight Council and others v HMRC [2015] EWCA Civ 1303

VAT repayments and limitation periods

Summary - The Court of Appeal dismissed the appeal by Leeds City Council ('Leeds') from the Upper Tribunal and upheld HMRC's decision to reject the late claim by Leeds for a repayment of output tax

Leeds City Council (Leeds) had made claims for the repayment of wrongly paid VAT under the Sixth VAT Directive Art 4.5, which applies to local authorities in respect of their activities as public authorities and provides that they are not to be considered as taxable persons, unless treatment as non-taxable persons would lead to significant distortions of competition.

The UK had not integrated Art 4.5 into domestic law. However, it was common ground that it was directly effective, that almost all the relevant activities fell within it and that treatment of Leeds as a non-taxable person would not give rise to significant distortions of competition. HMRC was therefore willing in principle to repay VAT for which Leeds had accounted before 4 December 1996, but not VAT for which Leeds had accounted after that date, on the basis of the combined effect of VATA 1994 s 80 and FA 2008 s 121. Section 80 (in force from 4 December 1996) imposed a three-year limitation period for making claims for the repayment of wrongly paid VAT, while s 121 (in force from 19 March 2008) disapplied that limitation period in relation to VAT accounted for or paid before 4 December 1996, provided that the claim was made before 1 April 2009.

Leeds relied on the EU law principles of effectiveness, equivalence, proportionality, legal certainty and legitimate expectation in arguing that the domestic limitation period was invalid. The Court of Appeal pointed out that the question was whether Leeds had been given a 'readily ascertainable prospective opportunity of a reasonable length' within which to bring its claims. If so, in the absence of special circumstances, none of the applicable principles of EU law had been breached.

Decision:

The Court of Appeal observed that Leeds would have known that as regards any overpayment of VAT made on, say, 5 December 1996, it had until 5 December 1999 to make a claim. This was a 'readily ascertainable prospective period' of a reasonable length. Since the live claims all related to VAT in accounting periods after 4 December 1996, those claims had never had the benefit of any longer limitation period; and there had been no retrospective alteration of the limitation period applicable to these claims.

Comments - The retrospective introduction of the three-year cap without transitional relief prompted a lot of litigation. This in turn produced changes in HMRC's policy and further legislation. In effect, Leeds used the arguments from the *Scottish Equitable* case that the three-year cap was ineffective due to the way it was introduced in 1996. This is an important, but expected, victory for HMRC in their difficult struggle to implement the shorter cap. Leeds may seek leave to appeal to the Supreme Court, but the chances of success for this seem slim.

Leeds City Council v HMRC EWCA

Deemed supply between associated companies?

Summary – The First-tier Tribunal (FTT) allowed the appeal against HMRC's decision that there had been a supply of goods when a sister company started to carry on the appellant's business and use its assets. However, there had been a supply of services, so the FTT stayed the proceedings for the parties to try to agree the VAT treatment.

The issue at stake was whether Beauty Angels, a company carrying on a beauty salon business, made a deemed supply of the goods used in the business for deemed consideration, when another company (BASL), which was not registered for VAT and which belonged to the same shareholders, had started carrying on the business whilst Beauty Angels had ceased to do so.

VATA states that 'Where goods forming part of the assets of a business are transferred … so as no longer to form part of those assets, whether or not for a consideration, that is a supply … of goods.' The FTT saw that it was clear that the assets no longer formed part of the business of Beauty Angels. The issue was therefore whether they had been 'transferred'.

Decision:

There had not been any sale of the assets. As no deed had been entered into, no gift had taken place either. The FTT therefore had to ascertain whether 'delivery of possession' had taken place. The FTT found that since Beauty Angels had not undertaken any 'unequivocal action', legal title to the salon assets had not been transferred and Beauty Angels had not made a supply of goods.

However, Beauty Angels had made a supply of services by making the assets of the salon available to BASL. The decision was stayed to allow the parties to agree on the quantum and timing of any VAT arising.

Comments - The special rules for transfers of a business as a 'going concern' did not apply, because BASL was not registered for VAT. This case illustrates the danger of changing a business without first obtaining VAT advice.

Beauty Angels Ltd v HMRC TC4683

The DIY Housebuilders scheme and very long projects

Summary - The First-tier Tribunal (FTT) allowed the appeal against HMRC's decision that a house and garage had not been constructed at the same time for the purposes of the DIY House Builders Scheme. A builder was entitled to a refund under the DIY Housebuilders scheme, even though part of the project had been completed some 20 years before the application for refund.

The original planning permission had described the development as: 'Erection of a building and garage. Construction of a new vehicular and pedestrian access and driveway.' Planning permission for a garage block, greenhouse, garden shed, pergola and swimming pool had subsequently been applied for and granted.

A certificate of completion had been issued in 1994. However, Mr Bowley had only applied for a refund under the DIY scheme in February 2014 as the garage block had only been completed then.

HMRC had denied the refund on the ground that the claim had not been made within three months of completion of the works. HMRC accepted that it is possible to make a claim under the DIY scheme within three months after completion of a dwelling, no matter how long the construction of the dwelling may take. The issue was therefore whether the house and the garage block had been constructed at the same time.

Decision:

The FTT observed that the fact that the garage had been the subject of a separate planning permit was not decisive. It simply evidenced a change in the original project. A DIY building project did not cease to be a single continuous building project because of significant gaps between bursts of activity, provided that the project could overall still be characterised as a single continuous building project. Finally, a reinforced floor slab had been laid for the garage block only five weeks after completion of the house. The FTT concluded that both the house and the garage had been built as part of a single continuous project.

Comments - There is no requirement for a house and its garage to be completed at the same time. In practice, the work on one of them is likely to be completed before the other. There is no limit to the period of time that a DIY project can take as can be seen from this case. During many DIY projects, work is not undertaken all day or every day. Work may take place in bursts, with gaps in between. The gaps were clearly quite long in this case.

Bowley v HMRC TC4800

Special investment funds

Summary – The ECJ has ruled that the availability of the VAT exemption for collective investment schemes was not limited to investment undertakings investing in transferable securities and, therefore, was available in respect of funds investing in immovable property

The key issue was the interpretation of the Sixth Directive, art 13B(d)(6), which exempts from VAT the management of special investment funds. A Dutch 'fiscal entity' provided property management services to three investment companies.

Decision:

The CJEU had to decide whether the three investment companies, which pooled capital from investors with a view to purchasing, owning, managing and selling immovable property in order to derive a profit to be distributed to unit-holders, were 'special investment funds'. The Court highlighted that the purpose of the exemption was to ensure that VAT was neutral in relation to the choice between a direct investment and an investment through a collective investment fund. The Court Commented that funds which constitute collective investment funds within the meaning of the UCIT Directive are special investment funds. However, real property investment was not within the scope of the UCIT Directive. The three companies could therefore only be special investment funds if they were subject to state supervision in a similar way to investment vehicles which came within the scope of the UCIT Directive.

Comments - In this case, the ECJ were asked to consider whether the VAT exemption for 'the management of special investment funds as defined by member states' extended to funds investing in immovable property, noting that the exemption of transactions connected with the management of special investment funds was, particularly, to facilitate investment in securities in order to neutralise the common VAT system as regards the choice between direct investments in securities and investment through collective investment undertakings. The ECJ found that the fact that the investments were in immovable property was of no consequence and the exemption applied. However, 'management' of the immovable property itself was beyond the scope of the exemption which applied only to transactions specific to the business of undertakings for collective investment

Staatssecretaris van Financien v Fiscale Eenheid X NV cs (C-595/13)

Unjust enrichment – What is the cost?

Summary - The FTT has determined that repayments to golf clubs (following the ECJ decision in the Bridport and West Dorset Golf Club case) that had charged VAT on green fees should only be reduced by 10% on the ground of unjust enrichment.

Green fees are charges made by members' golf clubs to non-members to play at and use the facilities. In *Bridport and West Dorset Golf Club*, the CJEU had found that the UK was not entitled to rely on the Principal VAT Directive, arts 134(b) or 133(d), to exclude the supply of green fee golf by non-profit making clubs from the exemption. Consequently, many golf clubs had sought repayment from HMRC of output tax on green fees. Four clubs (including Berkshire) were chosen as broadly representative of all the claims.

HMRC raised the defence of unjust enrichment. Both parties instructed experts. It was agreed that the clubs had suffered an economic loss, comprising the VAT which was not passed on to the green fee visitors and the net profit on rounds of green fee golf that would have been played had some potential visitors not been deterred by the increased (VAT inclusive) price.

Decision:

The issues were the extent of the loss and the way it should be calculated. Each expert approached the question with the help of a theoretical economic model. The FTT preferred the golf clubs' model. It relied on the fact that the green fee market was not a 'perfectly competitive' but a market which is dominated by a small number of sellers.

The FTT found that a restriction of 10% should be applied to each of the clubs' claims to take account of the fact that they would have incurred some costs in providing rounds of green fee golf to the additional number of visitors who would have played, had the green fees been lower by the amount of VAT incorrectly imposed.

The FTT also found that, other than in the case of tour operators or travel agents acting as agents and invoicing green fees directly to a golfer, supplies of green fee golf which were on-supplied to individuals by tour operators were subject to VAT at the standard rate. Similarly, corporate day packages offered by golf clubs were taxable supplies because the corporate body was the true recipient of the supply.

Finally, as far as course expenditure was concerned, if the course was also used for taxable purposes (tee sponsorship/advertising and buggy hire), such expenditure should be regarded as 'residual' and any input VAT incurred on those costs could be reclaimed by a golf club in accordance with its agreed partial exemption formula.

Comments - This was the lead case in respect of the unjust enrichment and other aspects of claims for repayment of VAT on visitor's green fees to golf clubs following the decision of the Court of Justice of the European Union (ECJ) in Bridport and West Dorset Golf Club Ltd that visitor's green fees charged by non-profit making members clubs were exempt. The FTT's finding is likely to be very costly for HMRC given the large number of claimants. It is therefore likely that HMRC will appeal.

Berkshire Golf Club; Glen Golf Club; Wilmslow Golf Club v HMRC TC4774

Wrong flat rate scheme by taxpayer

Summary – The Tribunal dismissed the taxpayer's appeal against the assessment for the under-declared VAT

The taxpayer, a postmaster, operated the flat rate scheme on his main business activity of "retailing food, tobacco and confectionery, newspapers or children's clothing". He applied the correct rate, 2%, but should have increased it to 4% after January 2011. The error came to light in 2014 and this led to an assessment of £13,869, for the under-declared VAT. The taxpayer asked HMRC whether he could withdraw from the scheme retrospectively because his extra liability with normal VAT accounting would be smaller than the amount assessed. HMRC refused.

The taxpayer said HMRC should have notified him of the percentage change in 2011 and, had they carried out an earlier compliance visit, the tax owed would have been less than £13,860. He appealed to the First-tier Tribunal.

Decision:

The tribunal judge agreed with the taxpayer that it would be helpful if HMRC emailed reminders to traders about changes to the flat rate as they do each quarter for returns. But, ultimately, it was the trader's responsibility to ensure he applied the correct percentage.

The tribunal had no jurisdiction to decide whether the taxpayer should have been allowed to withdraw retrospectively from the scheme. Instead it could consider whether HMRC's decision not to allow a withdrawal was reasonable. In this instance, there were no exceptional circumstances, so the judge concluded HMRC had acted reasonably.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, said: "There is scope to withdraw from the flat rate scheme retrospectively if HMRC agree to the request but any request based on the motive of paying less tax is likely to fail. HMRC recognise the time savings of the scheme rather than tax savings, and the tribunal's power is limited to confirming whether HMRC's refusal to backdate the withdrawal date was fair."

John Pryor v HMRC TC4702

VAT liability of vouchers forming part of a promotional scheme

Summary – The UT upheld the FTT decision regarding output tax, finding that VAT was not due on the vouchers given away free of charge because this was for strictly business-related purposes and accordingly was not deemed to be a supply of services. The UT allowed HMRC's appeal in part in respect of the input tax recovery for vouchers issued by retailers only (and not intermediaries).

The taxpayer ran promotions to encourage sales of its newspapers. The company bought retail vouchers which it provided free to readers. A dispute arose as to whether this was a supply of services and whether the taxpayer could deduct input tax on the purchase of the vouchers.

The First-tier Tribunal had found that the provision was not a supply of services, so no VAT would be due under the VAT (Supply of Services) Order, SI 1993/1503, article 3.

On the second issue, the tribunal held that the taxpayer was entitled to deduct input VAT on the purchase of the vouchers at a "blended" rate, reflecting an estimate of the liability to VAT on supplies by retailers on redemption.

HMRC appealed.

Decision:

The Upper Tribunal said, viewed objectively from an economic perspective, the vouchers had been acquired for a business promotion scheme to increase the circulation of the taxpayer's newspapers and encourage advertising sales. Their purchase was therefore directly and immediately linked and input tax was deductible.

However, under VATA 1994, Sch 10A para 4(2) the consideration for the issue of a retailer voucher is disregarded for the purposes of VAT. As a result, retailers accounted for VAT on supplies of goods or services only on redemption of the vouchers. They did not have to account for VAT on their issue. Therefore, the taxpayer was not entitled to recover input tax on vouchers bought from retailers, although it could on those purchased from intermediaries. The Revenue's appeal on the second input tax issue would be allowed.

On whether there had been a supply of services, the First-tier Tribunal had made no error of law in determining that the provision of the vouchers by the taxpayer to its customers as part of a promotion had been for business-related purposes and should not be deemed a supply of services. No output tax liability therefore arose.

HMRC's appeal was allowed in part on the basis that the taxpayer was not entitled to recover input tax on vouchers issued by retailers.

Comments - If this decision stands it is likely to have implications for others using vouchers for business promotion campaigns, but given the complexity of the legislation involved we may potentially see further appeals.

CRC v Associated Newspapers Ltd, Upper Tribunal

Domestic reverse charge for businesses wholesaling telecommunications services

Introduction

The government has laid legislation, in the form of a statutory instrument, to introduce a reverse charge accounting mechanism (domestic reverse charge) for wholesale supplies of telecommunications services in the UK. This is in response to the threat of missing trader intra-community fraud in those supplies. The purpose of this brief is to provide guidance on how the domestic reverse charge will operate. It should be read in conjunction with VAT Notice 735: VAT domestic reverse charge on specified goods and services.

Who should read this brief

Businesses that buy or sell wholesale telecommunications services in the UK, including

- airtime carriers
- network operators
- message hubbing providers
- short messaging service (SMS) and voice aggregators

Background

A domestic reverse charge means the customer receiving the wholesale supply of telecommunications services must account for the VAT due rather than the supplier. In turn the customer deducts the VAT due on the supply as an input, meaning no net tax is payable to HM Revenue and Customs (HMRC). This removes the scope to evade any VAT owing to HMRC. The UK has introduced similar measures, in response to criminal threats, for mobile telephones, computer chips, emissions allowances, gas and electricity.

Timing and scope of implementation

Timing

The reverse charge will take effect from 1 February 2016 and will apply to the wholesale buying and selling of telecommunications services in the UK, subject to certain exceptions. HMRC recognises this timetable may be challenging for some businesses. It will be adopting a 'light touch' approach regarding penalties to help those who are making reasonable efforts to comply but may not be able to do so in time.

What is covered by the reverse charge

Subject to certain exceptions, the domestic reverse charge will apply to all wholesale supplies of telecommunications services between counterparties established in the UK. This will typically mean transmission or carriage services of airtime and telephony related data.

The reverse charge will cover telecommunications services which enable:

- speech communication instantly or with only a negligible delay between the transmission and the receipt of signal
- the transmission of writing, images and sounds or information of any nature when provided in connection with services described above

Examples of services covered by the reverse charge include:

- wholesale switched voice services, including switched voice over internet protocol (VOIP) services
- wholesale SMS and multimedia messaging service (MMS) services (eg push messages)
- wholesale "Over The Top" telecommunications messages
- SMS hubbing
- SMS and voice aggregator services

The above list is not exhaustive.

What is meant by 'wholesale supplies'

In terms of the reverse charge wholesale supplies takes its normal meaning of being business to business supplies where the intention is to sell on the supply with no or negligible consumption of the supply by the businesses concerned.

For telecommunications services it means supplies between carriers of these services (in the UK), or supplies of these services to network operators for onward supply to the consumer or user of the underlying service.

Exclusions

The domestic reverse charge will not apply in the following circumstances:

- non-wholesale supplies
- transport/capacity and related access services (i.e. wholesale line rental, lease lines)
- Indefeasible Right of Use charges (IRUs)
- broadband and other data transmission only services
- supplies for final consumption
- supplies to a member of a corporate group for onward supply within that corporate group, and where the corporate group members consume that supply
- the return of unused minutes that were not originally subject to the reverse charge
- supplies where section 8 of the VAT Act 1994 (reverse charge on supplies received from abroad) applies
- supplies where Schedule 10A of the VAT Act 1994 (face value vouchers) applies
- businesses not registered or liable to be registered for VAT

Incidental or bundled supplies

There may be supplies which contain a mixture of reverse charge and non-reverse charge supplies, for example supplies to mobile virtual network operators (MVNOs), and it's impossible or impractical to separate out the element subject to the reverse charge. In these cases it's acceptable for the reverse charge to apply to the whole supply.

The domestic reverse charge mechanism

How does the domestic reverse charge mechanism work?

Under the domestic reverse charge, it's the responsibility of the customer, rather than the supplier, to account to HMRC for VAT on supplies of telecommunications services. It will only apply to business to business transactions in the UK where those businesses are registered or liable to be registered for VAT.
This is the same as the mobile phone, computer chip, emissions allowances, gas and electricity domestic reverse charges.

The de minimis rule and Reverse Charge Sales List

As is the case with the emissions allowances, gas and electricity domestic reverse charges:

- there is no 'de minimis' rule excluding supplies under £5,000 so the domestic reverse charge applies to all supplies of electronic communications services, except where those supplies are specifically excluded
- businesses are not required to complete a Reverse Charge Sales List

Completion of the VAT Return

Suppliers

Suppliers of goods or services under the domestic reverse charge must not enter any output tax on sales to which the domestic reverse charge applies in box 1 of the VAT Return. The value of such sales must be entered in box 6.

Customers

Customers must enter the output tax on purchases to which the domestic reverse charge applies in box 1 of the VAT Return. The value of such purchases must not be entered in box 6.
They must reclaim the input tax on their domestic reverse charge purchases in box 4 of the VAT Return and include the value of the purchases in box 7, in the normal way.

Invoicing

When making a supply to which the domestic reverse charge applies, suppliers must:

- show all the information normally required to be shown on a VAT invoice
- make a note on the invoice to make clear that the domestic reverse charge applies and the customer is required to account for the VAT

The amount of VAT due under the domestic reverse charge should be clearly stated on the invoice but shouldn't be included in the amount shown as total VAT charged.

If you produce invoices using an IT system, and the system can't show the amount to be accounted for, you should read section 7.5.1 of VAT Notice 735.

Under EC law and the VAT Regulations 1995, invoices for domestic reverse charge supplies, when the customer is liable for the VAT, must include the reference 'reverse charge'. The following examples fulfill the legal requirement:

- Reverse charge: VAT Act 1994 Section 55A applies
- Reverse charge: S55A VATA 94 applies
- Reverse charge: Customer to pay the VAT to HMRC

Tax points
The provision of a telephonic service is a continuous supply of services. The tax points are therefore the issue of a VAT invoice or the receipt of payment, whichever is earlier (Regulation 90 of the VAT Regulations 1995). Additionally, in certain circumstances, where there is a delay beyond one year in issuing a VAT invoice or receiving payment, an annual tax point will apply (Regulation 94B(5) of the VAT Regulations 1995).

Penalties
HMRC understands the difficulties businesses may have in implementing the domestic reverse charge and will apply a light touch in dealing with errors that occur in the first 6 months after introduction.

Further guidance on the application of the domestic reverse charge
Detailed guidance on the other domestic reverse charges can be found in VAT Notice 735: VAT domestic reverse charge on specified goods and services. This will be updated in due course to include guidance for telecommunications services.

Current law and draft legislation
Current law

Section 1(2) of the VAT Act 1994 makes the supplier liable for any VAT in supplies of goods or services.

Section 55A of VAT Act 1994 provides that the recipient of a supply must account for the VAT due on supplies of a kind specified in an order made by the Treasury.

EU legislation in Article 199a of Directive 2006/112/EC allows member states to provide for a domestic reverse charge for supplies of telecommunications services as defined in Article 24(2) of the Directive.

Draft legislation
A statutory instrument will bring the relevant changes into effect: VAT (Section 55A) (Specified Services and Excepted Supplies) Order 2016 (SI 2016/12)

R&C Brief 1/2016

VAT grouping provisions following the Larentia + Minerva and Marenave and Skandia

Purpose of this Brief

To inform interested parties of the UK government's decision to launch a consultation on VAT grouping provisions and highlight the planned approach.

Who should read this brief?

UK VAT-registered businesses who are members of a VAT group and other businesses who are interested in applying for VAT grouping. Accountants, consultants and others who provide VAT advice to the businesses referred to above.

Background

Article 11 of the Principal VAT Directive allows member states to treat two or more businesses established in the territory of that member state as a single taxable person (often called a VAT group) if the businesses have close economic, financial and organisational links.

UK VAT grouping legislation (VAT Act 1994 s43-43D) currently allows two or more companies or limited liability partnerships - known as 'bodies corporate' - to register as a VAT group if:

- each body is established in the UK
- they are under common control, for example a parent company and its subsidiaries

Further details can be found in VAT Notice 700/2: group and divisional registration.

The Larentia + Minerva and Marenave judgment was released in July 2015. The Court of Justice of the European Union found that member states may only restrict VAT grouping to legal persons, where those restrictions are appropriate and necessary in order to prevent, abuse, avoidance or evasion. As a result of this judgment the government expects to make changes to UK law and VAT grouping provisions.

These changes are likely to include:

- extending VAT grouping to non-corporate bodies
- identifying new rules to determine 'close economic, financial and organisational' links for corporate and non-corporate bodies, replacing the current "control" test based on a company law definition of a subsidiary

The government recognises the importance of engaging fully with individuals, practitioners, businesses and other organisations in the development of tax policy. The consultation process will help HM Revenue and Customs (HMRC) gather views on policy design, impact of change and alternative approaches to develop new legislation.

We will also use this opportunity to find out what businesses and their representatives think about other grouping related matters, particularly those where the provisions differ across EU member states, as identified in the Skandia case. This information will help inform future discussions with the European Commission and other member states.

What happens next?

During January and February 2016 HMRC will meet with business representative bodies to explore and develop new ideas on VAT grouping.

During February and March 2016 HMRC will use the feedback to develop a series of policy options. These will form part of the formal consultation which will begin in spring 2016.

During spring 2016, HMRC will launch a formal written consultation. This will provide anyone who has an interest in VAT grouping with an opportunity to reflect on the policy options and proposals developed during the informal dialogue. We will ask for feedback on the impact and workability of these proposals to help us determine the final shape of VAT grouping provisions.

The formal consultation period will last for 12 weeks.

During summer/autumn 2016, we will publish a summary of the formal consultation responses, and use it to finalise the government's proposals for reform of VAT grouping provisions.

R&C Brief 3/2016

VAT MOSS - Simplifications for businesses trading below the VAT registration threshold

Purpose of this brief

This brief outlines the simplifications available to businesses trading below the UK's VAT registration threshold (currently £82,000) that make supplies of digital services (telecommunications, broadcasting or electronically supplied services) to consumers in other EU member states. Some simplifications are already in place and this brief announces 2 new areas of help for the smallest businesses.

Who should read this brief

You should read this brief if you provide digital services to consumers or other non-business customers in other EU member states and your total turnover is below the UK VAT registration threshold.

Background

On 1 January 2015 the VAT place of supply for digital services supplied to consumers and other non-business customers inside the EU changed from where the supplier belongs to where the customer belongs. Businesses making these supplies became liable to register for VAT in each country where they supplied digital services.

To make it easier to comply with this change the VAT MOSS system was introduced. Businesses using VAT MOSS can declare and pay the VAT due on their sales of digital services to customers across the EU using a single return and payment. This can be done in their home member state, instead of registering for VAT in every member state where the VAT is due. More information on the place of supply rules can be found in the guide VAT: supplying digital services to private consumers.

Simplifications if you trade below the UK VAT registration threshold

The UK has introduced additional measures to reduce the impact of the changes for smaller businesses.

Evidence of where your customer belongs

Businesses need to determine where their customer is located. There are specific rules in place for certain types of transactions.

For all other supplies of digital services, the normal rule is that businesses must collect two pieces of non-contradictory information to evidence their customer's location.

From the start, HM Revenue and Customs (HMRC) has allowed UK businesses that are below the UK VAT registration threshold and registered for VAT MOSS to base their customer location decisions on a single piece of information provided to them by their payment service provider. HMRC introduced this simplification in response to feedback from small businesses that said that they found it difficult to obtain 2 pieces of evidence.

HMRC recognises that some small businesses have still found this difficult. They are now going a step further and allowing businesses below the UK VAT registration threshold to exercise their best judgement. This means businesses can rely on any single piece of information, such as the address provided by the customer, to determine where their customer is located. This additional flexibility will provide additional help for businesses below the UK VAT registration threshold.

Consider if you're in business – and therefore within the scope of the changes

There is no registration threshold on cross border supplies of services and businesses of all sizes fall within the scope of the changes. However, this only applies where supplies are made in the course or furtherance of a business. If activity is carried out as a hobby (ie only on a minimal and occasional basis), HMRC does not normally see this as a business activity for VAT purposes.

HMRC's analysis of the VAT MOSS returns submitted by UK businesses so far indicate that some of those registered for VAT MOSS may not be in business for VAT purposes.

HMRC will contact those already registered for VAT MOSS whose returns suggest they may not be in business.

Guidance on what you need to consider when deciding whether your activity is by way of business can be found in HMRC's VAT Business/Non-Business Manual.

VAT MOSS registration

One of the existing simplifications is that businesses that fall under the current VAT registration threshold of £82,000 may register to use VAT MOSS for their cross border sales. These businesses can still benefit from the UK's domestic VAT registration threshold and do not have to account for VAT on supplies to UK consumers.

R&C Brief 4/2016

VAT fraud – 4 or 20 years? (Lecture B939 – 10.52 minutes)

Introduction

Employee fraud can run undetected for many years with the amounts often being small and not easy to spot. Detection is sometimes by professional advisors, sometimes by chance, sometimes by lifestyle suspicions or occasionally self-admission. Once detected the employee has usually spent the funds that have been misappropriated and so is in no position to repay them. Where does this leave the company?

Example

Consider a reasonable size business with a small accounts team where one member of the accounts team is posting random purchase invoices twice and making payments on the duplicated invoice to their own bank account. The amounts total only £30,000 per year but this has gone on for ten years.

Given that the company's turnover is £6m, a fraud of this size would be difficult for anyone to spot when it is well orchestrated but eventually it is detected. The employee is in no position to repay the £300,000 and the matter is passed over to the police.

Having looked into the matter, the accountants calculate that £50,000 of input VAT has been over-claimed as a result of the duplicated purchase invoices. What action should the company take?

Company action

The critical question is whether the company has been involved in a careless action or in deliberate action.

Careless action:

- maximum penalty is 30% of the over-claimed input tax which can be mitigated to zero with an unprompted disclosure
- 4 year cap will apply.

Deliberate action:

- maximum penalty is 70% which can be mitigated to 20% with an unprompted disclosure
- 20 year fraud cap will apply

Careless or deliberate?

There is no statutory definition of careless action or deliberate action so the ordinary English meaning should be applied.

In HMRC's manuals they believe that deliberate behaviour would include Directors positively deciding to submit something to HMRC that was wrong so for example, their VAT return.

The fact that an officer signs a document on behalf of the company is not, in itself, evidence that the inaccuracy is attributable to that officer's deliberate action. The VAT return may be wrong but if they believed it to be correct, it is hard to see how their action can be anything other than careless.

McNicholas Construction Co Ltd v C&E Commrs, QB [2000]: The company was subject to extended time limit assessments and dishonest conduct penalties on the basis of dishonesty of site managers and a contract manager who reported directly to the company's chief executive. Fraud was part of how the business was being operated rather than something that one individual had perpetrated.

Keith Motors (Christchurch) Ltd: The company was the victim of a fraud by its accountant and so the dishonesty penalty was discharged.

So it would seem that if the directors or senior managers are involved in the fraud, then the company is implicit in the fraud and the action is seen to be deliberate. By contrast, where an inadequately supervised employee commits the fraud, the company is seen to be the victim of the fraud and the action is careless.

United European Gastroenterology Federation: The organisation became aware that it had made a careless error and asked their accountants to quantify it so a disclosure could be made. HMRC independently launched an enquiry before the disclosure had been made. Even though it was clear that the organisation would have made the disclosure shortly afterwards without HMRC's action, the disclosure was regarded as prompted rather than unprompted and the minimum penalty of 15% was applied. It is important to note that as soon as you become aware of an error, you should disclose it.

What should the company do?

It would be advisable to inform HMRC as early as possible that an employee fraud has been committed as failure to do so may lose the "unprompted" nature of the disclosure.

In the disclosure, explain that:

- further work is being undertaken to quantify the extent of the employee fraud
- a full report will be forthcoming at the earliest opportunity
- adjustments will be made for the VAT quarters within the four year cap

HMRC may issue protective assessments for a quarter that is about to go out of time but they should wait until the report is complete before getting involved.

When assessments are issued simple interest at 3% will be applied and penalties should be zero if unprompted disclosure made with full cooperation.

VAT mark up exercise on a fish and chip shop (Lecture B940 – 14.49 minutes)

Introduction

HMRC came unstuck in the recent First-tier Tribunal case of Ernest Bustard (TC4703), when they tried to carry out a weighted mark-up exercise on a fish and chip shop in Belfast. The figures they produced to project the expected sales figures for the business (a lot higher than the declared takings on the VAT returns submitted by the business in the periods under review) proved to be very unreliable and the only surprise is that the whole scenario reached the courts. It was not HMRC's best day at the office and they rightly lost the case. However, to balance the books, the taxpayer did not help himself either, so there are plenty of learning points from the case.

HMRC approach to mark-up exercises

The main purpose of a mark-up exercise is so that HMRC can establish the credibility of a taxpayer's declared sales figures shown in either his annual accounts or on his VAT returns (or possibly both). So their strategy is to identify a representative quarter (the period chosen in the Bustard case was July 2009) and look at the mark-up made on each particular line of goods sold by the business. As an example, Mr Bustard was making a 183% mark-up on 'cod' and a much better 580% on 'chips'. The individual mark-ups are then applied to the total purchases of each item for the period in question to arrive at an expected selling price and therefore an overall weighted mark-up percentage. Allowances should then be made for wastage, discounts, staff meals and free supplies to reflect the fact that some goods are not sold at full selling prices.

I remember from my Customs and Excise days that a mark-up exercise was only really effective when the goods bought by a business were resold in the same state. So it is ideal for a confectioner, tobacconist or public house. But it is very difficult for a catering business such as a fish and chip shop where goods are mixed up and cooked and all sorts of things happen before they are sold to the customer. And this was the crux of HMRC's problems in the Bustard case: they started with a weighted mark-up of 268% when they began their enquiry in 2010 and a sales difference in the previous six years of £687,854 excluding VAT (the declared mark-up of the business was about 160%). But after proper thought was given to employee meals, wastage, discounts, free food and condiments, the sales difference came down in stages to £253,643 by November 2012. And by September 2013 (it was a very long running enquiry), the difference was £171,535 and a VAT liability of £26,342

What about the missing cash?

A point raised by the taxpayer's accountant early in the proceedings back in 2010 was that the missing cash supposedly suppressed by the business owner worked out at nearly £10,000 a month. The accountant gave HMRC access to all of the owner's private bank accounts and rightly pointed out that in the four year period up to 2009, the accounts showed drawings of £357,000, so it was not as if the owner was using the money to fund his living expenses. But by the time that HMRC had reduced their figures in 2013, the cash difference was down to about £500 a week, much more sensible but still disputed by the accountant.

Any mark-up assessment or similar calculation based on estimated figures should be made according to the officer's 'best judgment' (s73(1), VATA1994). And an important stage in the 'best judgment' process is to consider what has happened to the missing cash – there should be at least some clues in relation to eg the taxpayer's lifestyle.

Taxpayer actions

There are two sides to this story, and the taxpayer created a few problems with his own actions. The case is also a warning for advisers about the need to ensure that retail clients adopt diligent record keeping and show full openness with HMRC. So here is a summary of why the taxpayer's actions whetted HMRC's appetite and encouraged them to carry out an extensive mark-up exercise:

The business only had one till but did not retain till rolls or details of 'z' readings. When HMRC returned for a second visit in November 2009 (having asked Mr Bustard to keep details of his 'z' readings for a full period), he had not carried out this request and was also clearing down his till as well.

When he eventually kept till records, HMRC were surprised that 1/6 of the entries related to either a 'no sale' or a 'cancelled' entry. They suspected this was a method to suppress takings, although the court accepted subsequent explanations by staff that this was linked to a somewhat bizarre method of dealing with telephone orders.

The VAT returns recorded 2.5% of total sales as relevant to zero-rated sales of cold take away food but with no basis for this adjustment. The business adopted a 'point of sale' retail scheme so had a responsibility to record the different VAT rates as each sale was entered into the till.

A review of 2010 purchase invoices revealed some unusual items for a fish and chip shop…..sirloin steak, strawberries and cakes. It subsequently came to light that Mr Bustard was doing some external catering jobs. These jobs were apparently included in the annual accounts figures but missed from the VAT returns because his accountant thought they related to a separate business. Mr Bustard was also doing some consultancy work and not charging VAT.

Note – it is quite common for accountants and business owners to forget that it is the 'person' who is VAT registered and not a specific business. So Ernest Bustard was VAT registered as an individual and not as Flash in the Pan fish and chip shop.

What did the court think?

The court allowed Mr Bustard's appeal and cancelled the VAT assessment for £26,342 and the related penalty that HMRC had issued for 'deliberate and concealed' errors. Here are a couple of extracts from the case report:

"With regard to the weighted mark-up exercise, clearly individual items of food, such as fried fish or burgers, were sold at a fixed price. They were not priced depending on whether customers asked for a bap, mayo, lettuce, tomato or onions, but in HMRC's calculations it appears that these additional items had been grossed up as if they formed part of variable selling prices rather than fixed prices which the Appellant operated. As Mr Boyd said, that cannot be correct methodology." (para 152).

"As far as possible, our primary task is to find the correct amount of tax on the material available. On the basis of all the evidence, we find that the Appellant's gross profit margin during the appeal period has been accurately reflected in his accounts and VAT returns." (para 156).

Note – as a final twist in this case, when HMRC raised their final assessment for £26,342, in relation to sales that had been allegedly suppressed, their figures concluded that Mr Bustard had overstated his sales in 11 of the VAT periods covered by their assessment (total VAT of £16,804) and understated it in 16 of the periods (by £43,146).

To quote a comment made by the taxpayer's adviser (tribunal report - para 96):

"Mr Boyd says that this is an example of dogmatism and tunnel vision taking over from logic. Why would the Appellant overstate his VAT in any of those VAT periods?"

Contributed by Neil Warren