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Personal Tax

No benefit transferred to employees in the Court of Appeal

Summary - The court found that no benefit had been transferred to employees as they were paying market rate and also found that the employees should be treated as other group employees using their own cars and claiming business mileage. Therefore the appeal by HMRC was dismissed.

The corporate respondents to this appeal were six companies in the Newell & Wright group. Following changes in the law relating to tax on company cars in 2002, the group decided it would move to an arrangement whereby it would lease the cars to the workforce for an arm's length hire rental.

Because the respondents had formed the view that the provision of the cars was not a taxable benefit, they did not deduct the tax HMRC alleged to be due from the employees' pay under the PAYE scheme or notified HMRC that cars were being provided to the employees under the leases. HMRC, having concluded that the cars were subject to tax, served notices of assessment for that tax on the employees rather than on the group, under s29 TMA 1970. It was the employees therefore who brought the appeal before the Tribunal in respect of the liability to tax on the car benefit. The group's appeal related to HMRC's assertion that the group was liable to pay NICs in respect of the use of the cars and in respect of the taxation and NIC liability for the mileage allowance payments.

The Tribunal found that no tax and no NICs were due to be paid in respect either of the cars or of the mileage allowance. HMRC’s appeal asserted that the Tribunal erred in finding that the employees were not liable to pay tax on the cars and that the group was not liable (i) to account for PAYE on the mileage allowance payments made to the employees and (ii) to pay NICs on the cars under s10 SSCBA 1992.

Decision:

The principal issue before the Upper Tribunal and on this appeal was whether the arrangements for leasing the cars to the employees fell within Pt. 3, Ch. 6 ITEPA 2003. If so, it was common ground that both income tax and NICs were payable in respect of the cars. There was also an issue as to whether payments for mileage allowance, in respect of business use of the cars by the employees, were exempt from income tax as falling within the exemption provided by s.229 ITEPA 2003.

The main issue was whether s.114(3) ITEPA 2003 operated to exclude the application of Chapter 6 to the car leases. As s.114(3) applied only if an amount constituted earnings from the employment ‘in respect of the benefit of the car’ by virtue of any other provision, the court upheld the employees' submissions that as the employees paid the full market value for the cars there was no ‘benefit of the car’ within the meaning of s. 120 and hence nothing that could be liable to tax in this case.

The court considered that the choice of the word 'benefit', without any definition qualifying or altering its ordinary meaning, was intended to show that, before a charge to income tax in these circumstances arose, there must be a benefit to the employee in the ordinary sense of that word. It was not a case of implying a requirement or condition into Chapter 6. It was simply a case of giving meaning and effect to its express terms.

On the issue of mileage allowance the court stood back from the detail of the language and concluded that it was not easy to see why an approved mileage allowance paid to an employee who used his own private car for business journeys should be exempt from income tax, while such an allowance provided to an employee who paid full value for the lease of a car to him should not be exempt.

For the reasons stated above, the court concluded that the Upper Tribunal and the First Tier Tribunal were right to decide that a charge to income tax arose under Chapter 6 only if the terms on which a car was leased to an employee conferred a benefit on the employee in the ordinary sense of that word. The employees in this case received no such benefit.

Therefore the appeal by HMRC was dismissed.

Comments - This case adds clarity to the issues arising on the meaning of the term 'benefit' in the context of these provisions with ITEPA 2003. A common sense approach was adopted by the court in this case with reference to the commercial reality that if the employees were already paying a market rate lease then no benefit had been transferred. Likewise with the point on mileage allowance, the court took an equitable view.

R & C Commrs v Apollo Fuels Ltd & Ors EWCA

OTS options for alignment of tax and NICS

The Office of Tax Simplification (OTS) has published its report on the closer alignment of income tax (IT) and National Insurance contributions (NICs), making some bold recommendations for what would be a major reform of the UK's tax rules.

At Summer Budget 2015, the Government asked the OTS to look at options for aligning IT and NICs. This followed on from recommendations made by the OTS as far back as 2011, and this report builds on earlier work of the OTS including the reviews of small business taxation and employee expenses and benefits.

Key recommendations made in the report include:

- moving to an annual, cumulative and aggregated assessment period for employees' NICs similar to that for PAYE income tax;

- replacing employers' NICs with a flat rate charge on employer's total remuneration costs. The Employment Allowance would be retained to remove some small businesses from the charge;

- aligning NICs rates and thresholds between the employed and self-employed. This may mean the self-employed paying more NICs in return for better access to welfare benefits;

- aligning the rules for IT and NICs for employees; for example, a common definition of earnings; similar treatment of business expenses; and the extension of Class 1 NICs to benefits in kind;

- running IT and NICs as common, parallel systems. HMRC are encouraged to bring their IT and NICs teams closer together and to improve their guidance; and

- making NICs more transparent. Few of us understand how our NICs are calculated, what they fund and what we are entitled to. Once this is addressed (perhaps as part of HMRC's digital plans), a decision should be taken on the future of the contributory principle.

If enacted, these measures would significantly change the calculation and collection of NICs, bringing NICs more in line with IT and simplifying the UK's tax system as a result. But this would mean major upheaval and create winners and losers – the OTS estimates that moving to an annual, cumulative and aggregated assessment period for employees' NICs would mean 7.1m workers paying less NICs (an average of £175 p.a.) and 6.3m workers paying more (an average of £275 p.a.).

The OTS acknowledges that it will take time to achieve what would be a major reform of the UK's tax rules, and that a significant amount of additional work will be required to fully understand all of the implications of the proposed changes. The Government will now consider the recommendations made by the OTS.

Additional information can be found at http://tinyurl.com/zgoq5tn.

Further amendments to the benefit in kind regime (Lecture P951 – 9.35 minutes)

<u>Is it a 'fair bargain'?</u>

Where an employee reimburses his employer for a benefit in kind, the taxable value of the benefit is reduced. For certain benefits, the rule is that, if an employee receives goods or services at the same cost and under the same terms and conditions as a member of the public, he will have struck a 'fair bargain' with the employer so that no benefit will have arisen.

The Government are concerned that some employers have increasingly been using the 'fair bargain' rules to override the specific computational provisions applying to a range of benefits. Legislation has therefore been introduced in Cl 7 FB 2016 to make it clear that this let-out cannot apply to:

(i) living accommodation;

(ii) cars or vans (but subject to an exclusion where the employer's business is to hire cars or vans and the employee hires a vehicle on the same terms as a member of the public); and

(iii) loans.

This amendment has effect for 2016/17 and subsequent tax years.

Zero-emission vans

For several years, S155 ITEPA 2003 ensured that a company van was not subject to a benefit in kind charge for private use provided that it could not, in any circumstances, emit CO_2 by being driven. This meant that the van was powered entirely by electricity or by a hydrogen fuel cell.

This nil rate charge came to an end on 5 April 2015. For 2015/16, a figure of 20% of the normal van benefit for that tax year (ie. 20% x £3,150 = £630) was chargeable on drivers of zero-emission vans.

Thereafter, it was planned that the rate would rise on a tapered basis. By virtue of Cl 11 FB 2016, this will now take place more slowly in order to encourage the continued production of such vehicles.

The new rates are as follows:

Tax year	**Relevant percentage**
2016/17	20%
2017/18	20%
2018/19	40%
2019/20	60%
2020/21	80%
2021/22	90%
2022/23	100%

In other words, the charge for 2016/17 will be 20% x £3,170 = £634.

However, if the driver of a zero-emission van (or, indeed, any other van) meets the restricted private use condition set out in S155(4) ITEPA 2003, the cash equivalent of his benefit will remain at nil.

Contributed by Robert Jamieson

Employer provided living accommodation (Lecture B953 – 33.54 minutes)

Introduction

In 2010, the Government set up the Office of Tax Simplification (OTS) to give the Chancellor independent advice on simplifying the tax system. The OTS published two reports in 2014 which reviewed the tax treatment of employee benefits and expenses. This review included employer-provided living accommodation and highlighted the fact that, while the world of work has moved on, the tax rules for the provision of such accommodation have not. Many of these rules are nearly 40 years old.

The main findings of the OTS were that:

- there is a lack of clarity about what constitutes living accommodation and when and how the exemptions apply;
- the exemptions are outdated – newer types of businesses are not represented, while it is hard to see the reason for the continued existence of exemptions for some of the older occupations;
- many of the provisions appear somewhat arbitrary and can result in a very different tax treatment for employees in similar jobs – this creates complexity and unfairness; and
- calculating the value of the benefit is inherently difficult, depending, as it does, on whether the accommodation is owned or rented by the employer.

Government figures indicate that as many as 220,000 employees are currently residing in employer-provided living accommodation and so HM Treasury have recently asked a wide range of interested parties to give evidence about how well understood the tax rules are and to what extent they are relevant and appropriate in today's market.

<u>Types of accommodation</u>

The first problem area to be considered is the variety of forms of accommodation made available by employers to members of staff. They can be categorised as follows:

- living accommodation;
- accommodation provided as part of the travel and subsistence rules; and
- other accommodation.

The most important category is the first of these and it is in relation to this that the call for evidence is really aimed.

The term 'living accommodation' is not statutorily defined. However, in Para EIM11321 of the Employment Income Manual, HMRC explain that it is accommodation that allows an employee to live independently without recourse to others for his basic needs. In general, this means that, as well as having somewhere to sleep, it has to have bathing facilities and somewhere to prepare, cook and store food. Accommodation can fall into this category even if it is shared. The provision of living accommodation is a benefit in kind which is usually subject to income tax and Class 1A NICs – the

As far as the other categories are concerned, the legislation covering accommodation provided as part of the travel and subsistence rules relates to employees who, in the course of carrying out their employment duties, are required to spend one or more nights away from home. Normally, the provision of such accommodation does not give rise to any liability to income tax or NICs. The term 'other accommodation' refers to accommodation which does not fall within the definition of 'living accommodation' – it will typically refer to board and lodging or to accommodation where the employee cannot live independently. The provision of such accommodation is nearly always taxable.

The tax rules

The way in which living accommodation is valued as a benefit in kind is a complex matter and varies according to whether it is owned or rented by the employer. The following is a brief summary of the range of factors that need to be considered.

If the accommodation is rented by the employer, the taxable value of the benefit is the cost of the annual rental.

If the accommodation is owned by the employer, the taxable value of the benefit depends on:

- the property's 1973 gross rateable value (GRV);
- the length of time for which the property has been owned;
- when the employee moved in;
- the value of the property (and whether any renovations have been made to it); and
- whether the value of the property, at the time when the employee moved in, was greater than £75,000 and, if so, what the official rate of interest is.

The GRV is the value that was published in accordance with the General Rate Act 1967 in respect of every home in the UK. GRVs have not been updated since 1973, as a result of which they do not exist for many properties, ie. those built since the last rate review. This has meant that using such figures to calculate the taxable value of employer-owned living accommodation is becoming increasingly difficult. Where a value does not exist, employers have to ask the local District Valuer to provide a proxy GRV to be used for this purpose.

The main effect of using GRVs as the basis for calculating the taxable value of living accommodation is that the benefit value of occupying accommodation owned by an employer is invariably lower than the benefit value of accommodation which the employer rents.

A further complication is the special charge that was introduced by FA 1983 in respect of 'expensive' properties, ie. those costing more than £75,000. In view of the fact that this value has never been revised, most properties are nowadays classified as 'expensive'. This means that additional information has to be obtained in order to be able to calculate the relevant taxable value.

Illustration

Gregory Logistics plc has four employees who are all provided with living accommodation by the company.

These employees all do a similar job and receive the same salary. All the properties are three-bedroom semi-detached houses in the same area.

The GRV of each property can be taken to be £568. The official rate of interest for 2015/16 is 3%.

The relevant details are:

Employee 1: has lived in the house since the company purchased it in 2011 when it cost £190,000. The taxable value of this property is £568 + (3% x £(190,000 – 75,000)) = £4,018.

Employee 2: has lived in the house since the company purchased it in 1980 for a cost of £25,800. The taxable value of this property is £568.

Employee 3: has lived in the house since 2012. The company purchased it in 1980 for a cost of £25,800. The market value of the property when the employee moved in was £185,600. The taxable value of this property is £568 + (3% x £(185,600 – 75,000)) = £3,886.

Employee 4: has lived in the house since 2014. The company rents the property for £750 per calendar month. The taxable value of this property is £9,000.

This illustration proves the point made in 2014 by the OTS that, in relation to the taxability of living accommodation benefits, the playing field can hardly be described as level.

The OTS recommendation was that all living accommodation benefits should be taxed at the property's current rental value.

Exemptions

There are certain circumstances when living accommodation provided for an employee can be tax-free. The main exemptions are found in S99 ITEPA 2003 which states that there is a let-out if the living accommodation is:

- necessary for the proper performance of the employee's duties; or
- customarily provided within that occupation for the better performance of the employee's duties.

To be able to meet the first of these tests, case law has established that the claimant must be able to demonstrate that the employee must live in that accommodation – and no other – in order to do his job.

When considering the 'customary' requirement, the claimant needs to prove that, in practice, more than two-thirds of employers nationally provide living accommodation for people in that particular role and that they have been doing so for a number of years.

Para EIM11342 of the Employment Income Manual sets out the types of employee whom HMRC will accept as meeting the 'necessary' test. It is very difficult, if not impossible, for other claimants to satisfy HMRC that they fall within this exemption. Unfortunately, this list is out of date. For example, two of the categories of workers mentioned are lock and level crossing gatekeepers. However, nowadays virtually all lock-gates and level crossings are fully automated and so no-one is required to live on site in order to operate the relevant machinery.

Para EIM11351 of the Employment Income Manual has a similar list of employees who meet the 'customary' test. This one is less contentious. But the fact of the matter is that both lists can be seen to have created a closed set of occupations which qualify for relief under S99 ITEPA 2003 and this leads to the perception that new professions, however deserving, cannot force their way in. It is said that employees whose job titles fit those on the list are considered exempt without any real assessment of their role and duties. This led to the OTS reporting the feeling of many employers that the tax status of an occupation is dependent more on the person's job title than on the duties actually undertaken.

Conclusion

It seems clear that the nature and scope of the exemptions, along with the rules for taxing living accommodation, are in need of a radical revision.

Contributed by Robert Jamieson

Unauthorised Member payment

Summary - The First-tier Tribunal found that a loan made to a member by a third party on condition that funds of the pension scheme remained invested as specified in the loan agreement constituted an unauthorised member payment.

Mr Danvers (the appellant) had funds invested in two registered pension funds with an aggregate value of approximately £35,000. As he was aged under 50, he was unable to access any pension benefits. He therefore entered into an arrangement whereby the funds in his existing pension arrangements were transferred to HD SIPP, a pension scheme registered with HMRC, giving specific instructions for 100% of his fund to be invested in preference shares of KJK Investments Ltd (KJK), a company specialising in wholesale lending.

He also entered into a loan arrangement with G Loans Ltd (G Loans), a company to which KJK had lent a substantial sum, for an interest only loan of £18,656, the capital to be repaid from his pension fund. As a condition of the loan, money could not be disinvested from KJK or transferred out of HD SIPP.
HMRC sought to impose an unauthorised payments charge (s208 FA 2004) and surcharge (s209 FA 2004) on the grounds that the loan constituted an unauthorised member payment (s160(2) FA 2004).

It was agreed between the parties that the preference shares in KJK held by the HD SIPP were 'an investment acquired using sums or assets held for the purposes of' the scheme (s161(4) FA 2004) and therefore the question to be determined was whether or not the loan made by G Loans was 'a payment made under or in connection with' those preference shares.

Decision:

The FTT dismissed the appellant's argument that the loan was not a 'payment', in particular because, if a loan were not a payment, there would be no need for 'authorised employer loans' to be included within the class of 'authorised employer payments' in s175 FA 2004. Although it was accepted that KJK did not specifically allocate the money received from any particular investor to any particular loan, the FTT considered that the appellant transferred his pension funds to HD SIPP with a specific instruction to invest in KJK in order to obtain the loan from G Loans and therefore also concluded that the loan was made 'in connection with' the KJK preference shares. Accordingly the appeal would be dismissed.

Comment - In this case the FTT agreed that the purpose of the FA 2004 provisions relating to unauthorised payments was to prevent abuse by unauthorised access of the funds, but declined to consider whether or not the arrangements were abusive because this would involve judging what would have been Parliament's reaction to the specific arrangements. Instead the approach of applying the legislation to the specific facts and interpreting it as accurately as possible in its context was preferred.

Danvers v HMRC TC4810

Tax compensation payment

Summary - The First-tier Tribunal found that a tax compensation payment in relation to a foreign pension was not exempted from tax under UK law and was taxable under s566 ITEPA 2003 as a foreign pension.

Mr Sinnamon, the appellant, who represented himself, had been employed by the European Patent Office (the EPO) until his retirement in 2002. The Convention establishing the EPO (an inter-governmental organisation) includes a protocol that details a number of privileges and immunities from which the EPO may benefit. This includes an exemption from income tax in the contracting states in respect of salaries and emoluments (but does not apply to pensions and annuities paid to former employees). The protocol is brought into effect in UK law by the *European Patent Organisation (Immunities and Privileges Order)* 1978 (SI 1978/179).

From his retirement in 2002 until 2009, Mr Sinnamon received an EPO pension that was taxable in the UK. In recognition of the fact that the pension was taxable, he also received an additional payment (a 'tax adjustment payment'), which was also subject to UK tax, although the local tax authority was obliged to make payments back to the EPO in respect of the tax adjustment.

From 1 January 2009, the EPO Administrative Council replaced the tax adjustment payments with a partial compensation payment scheme that was subject to an internal EPO tax and did not impose any pay back obligations on local tax authorities. Minutes of the Administrative Council's meetings at which the new scheme was discussed showed that the intention was for payments under the new scheme to be exempt from national income tax, although it was recognised that this was not binding on any contracting state. Mr Sinnamon argued that the payments under the partial compensation scheme were not subject to UK income tax.

Decision:

As the Convention and Protocol of the EPO has no direct effect for UK tax purposes but is implemented for UK law purposes by SI 1978/179, the FTT considered that the only basis on which a tax exemption could be applied in the UK was under that statutory instrument, which provided for an exemption from income tax in respect of emoluments received as officers of the EPO. Although regard has to be taken of the legal characterisation of a payment by the source from which it is paid (in this case, the EPO) and therefore they were prepared to accept that there was an argument that the partial compensation payment was an emolument, it was not received by Mr Simmons as an officer, as he had ceased to be an officer in 2002, and they did not therefore accept that the payment was exempted by the statutory instrument.

The FTT then considered HMRC's contention that the partial compensation payment was taxable as a foreign pension payment under ss566 and 573 ITEPA 2003 and, on the basis that the EPO was based in Munich under the terms of the Convention and that the EPO pension scheme satisfied the requirements of the *Pension Schemes (Categories of Country and Requirements for Overseas Pension Schemes) Regulations* 2006 (SI 2006/206) and was therefore an overseas pension scheme within the meaning of s150 FA 2004, agreed that it was taxable under this head.

Comments - This case provides a useful reminder of the legal status for UK tax purpose of European Conventions and Protocols, which have no direct effect but are implemented and made effective by UK law.

Sinnamon v HMRC TC 4958

Capital Taxes

CGT – a reappraisal (Lecture P952/P953 – 29.06/ 21.29 minutes)

CGT rate reduction
Since June 2010, CGT has been charged at the following rates:

(i) 10% to the extent that the gains qualify for entrepreneurs' relief;

(ii) 18% where the taxpayer is not liable to income tax at the higher or additional rates;

(iii) 28% to the extent that the individual is a higher or additional rate taxpayer (this includes situations where the gains exceed any unused part of his basic rate income tax band);

(iv) 28% for trustees and personal representatives;

(v) 28% for ATED-related gains accruing to any person so chargeable (principally companies); and

(vi) 20% for NRCGT gains accruing to a non-UK resident company on the disposal of residential property situated in the UK.

Cl 72 FB 2016 reduces the 18% rate to 10% and the 28% rate to 20% for most gains made by individuals, trustees and personal representatives on or after 6 April 2016. The legislation also extends the 10% entrepreneurs' relief rate to include a brand new 'investors' relief' which will come into operation on 6 April 2019 (see below).

Gains accruing on the disposal of residential property interests which do not attract principal private residence relief remain subject to the 18% and 28% CGT rates. ATED-related gains continue to be taxed at 28%. Gains arising in respect of 'carried interest', ie. performance-based rewards for managers of investment funds, are also liable to the 18% and 28% charges.

A key objective of the present Government is the creation of – in their words – 'a strong enterprise and investment culture'. Cutting the CGT rates to 10% and 20% is intended to incentivise individuals to provide the capital which companies need in order to expand and create new jobs – hence the retention of the 18% and 28% rates for residential property. Taxpayers are being encouraged to invest in companies rather than in property.

Annual CGT exemption

The annual CGT exemption for individuals and personal representatives remains at £11,100 for 2016/17. The exempt amount for most trusts is £5,550.

Entrepreneurs' relief and associated disposals

Where an individual qualifies for entrepreneurs' relief on the disposal of shares, he can also obtain relief under S169K TCGA 1992 for the associated disposal of an asset used by his company. Typically, this will be property which is personally owned by the individual and has been used by the company for business purposes, but it can also cover the sale of intellectual property such as goodwill which is held outside the company by the vending shareholder.

There are similar provisions for a partner who owns premises or other business assets which are used for the purposes of the partnership trade.

The legislation requires various conditions to be satisfied before an associated disposal can attract relief. The main one is that the vendor making the associated disposal must do so as part of his 'withdrawal from participation' in the business carried on by his company or partnership. HMRC interpreted this requirement in the same way as they did for the corresponding retirement relief provisions. Thus the 'withdrawal from participation' test could be met by simply disposing of part of the individual's shareholding or partnership interest. Indeed, in early 2012, HMRC confirmed that, in the case of shares, the disposal of a single share would suffice – see page 8 of 'Entrepreneurs' Relief – Practical Points'. This was a guide for members of the CIOT on technical aspects of the relief which the CIOT had raised with HMRC (the guide can still be accessed on the internet). There is no requirement that the disposal of the owner's business interest has to give rise to a gain or, if it does, that it must be the subject of an entrepreneurs' relief claim. Nor is there any need for the vendor to reduce his workload, ie. he does not have to stop working for the company or the partnership.

FA 2015 made changes to S169K TCGA 1992 in relation to disposals made on or after 18 March 2015. It became a prerequisite that the disposal of the asset owned personally had to be accompanied by a significant reduction in the claimant's participation in the business. This condition was met if the business interest disposed of represented, in the case of a company, at least 5% of the company's ordinary share capital carrying at least 5% of the voting rights. With partnerships, the equivalent rule was that a 5% minimum interest in the assets of the partnership had to be disposed of. And there could not be any arrangements for repurchasing further shares in the company or a further partnership interest.

One of the problems with the FA 2015 legislation was that, if, say, a father made a gift of shares to his son or daughter in order to ensure that an associated disposal qualified for entrepreneurs' relief, HMRC were able to argue that the transaction fell foul of the share repurchase rules referred to in (i) above. These rules took account of the fact that the taxpayer or *any person connected with him* (the speaker's italics) was entitled to acquire shares in the company. Therefore, a gift of a 5% shareholding in a qualifying company to a son or daughter could invalidate the relief. Instead, it should have been a disposal to an unconnected arm's length purchaser, but, with many family-owned businesses, this would not of course be what the parties wanted. The provision is a good example of overzealous drafting of anti-avoidance legislation.

This outcome had never been the Government's intention. As a result, there are retrospective proposals in Cl 73 FB 2016 which aim to rectify the position. The revised rule ensures that, where the associated disposal takes place before the material disposal (ie. the disposal of the shares or the partnership interest), any arrangements connected with the latter cannot be 'share purchase arrangements' or 'partnership purchase arrangements' which could have the effect of denying entrepreneurs' relief on the associated disposal. In other words, a gift of shares to a son or daughter can count as an acceptable material disposal for this purpose.

Looking at partnerships, it should be noted that the 5% requirement has been dropped as long as:

(i) the material disposal is a disposal of the *whole* of the claimant's partnership interest; and

(ii) the claimant had owned 5% or more of the assets of the partnership throughout a continuous period of at least three years in the eight years ended with the date of this disposal.

Another new condition is that the associated asset must have been owned by the taxpayer throughout a three-year period ended with the date of its disposal.

All the above amendments have effect in relation to disposals made on or after 18 March 2015. In the words of HM Treasury:

> '(The) FA 2015 changes prevented certain abuses involving entrepreneurs' relief, but they also limited the availability of relief on some transactions where there was no abuse. The . . . changes made by (Cl 73 FB 2016) are backdated to the introduction of FA 2015 . . . in order to mitigate the disadvantage suffered by some as a result of the earlier changes.'

Disposal of goodwill

S169LA TCGA 1992 (as inserted by FA 2015) removed any entitlement to entrepreneurs' relief in connection with transfers of goodwill from an unincorporated business to a related close company, but only where that transfer took place on or after 3 December 2014. This was intended to put a stop to what had become the common incorporation practice of a sole trader selling goodwill to his new company for full value, with the sum owed being credited to the shareholder director's loan account. This could then be repaid by the company – tax-free – over the next few years instead of the company paying out a salary or dividends, either of which would be taxable at higher rates. Of course, this arrangement triggered a chargeable gain on the disposal of the goodwill, but the vendor would make a claim for entrepreneurs' relief so that his overall tax rate was nearly always significantly lower.

However, following Cl 74 FB 2016, the anti-avoidance provision will now only apply if a person disposes of goodwill directly or indirectly to a close company where he holds 5% or more of the company's ordinary share capital and voting rights. Shares and rights held by connected companies and trustees (but not by individuals) are taken into account in applying this replacement test. Thus, if someone sells goodwill to a close company in which they hold less than 5% of the ordinary share capital and voting rights, entrepreneurs' relief will still be available.

This rule has been backdated to disposals made on or after 3 December 2014, given that the original legislation was found to be too wide-ranging. As a further refinement, relief will also be due where an individual holds 5% or more of the ordinary share capital and voting rights if the transfer of the business is part of arrangements under which the close company will, within 28 days, be sold to – in effect – a new independent owner.

Meaning of 'trading company' and 'trading group'

Cl 75 and Sch 13 FB 2016 change the meaning of the terms 'trading company' and 'trading group' as they are used for the purposes of entrepreneurs' relief. The previous definitions found in S169S(4A) TCGA 1992 are no longer in point – instead, S169SA and Sch 7ZA TCGA 1992 set out the revised provisions dealing, in particular, with joint venture companies and corporate partnerships.

Although the activities of a joint venture company have not been treated, by virtue of FA 2015, as carried on by the company which holds shares in it, this rule is being retrospectively modified. A joint venture company is a company:

(i) which is a trading company or the holding company of a trading group;

(ii) where at least 75% of its ordinary share capital is held by five or fewer persons.

Where the new measure applies, a company which holds shares in a joint venture company will be treated as carrying on the proportion of the activities of that company which corresponds to the investing company's fractional shareholding in it. Similarly, activities carried on by a company in its capacity as a partner in a firm will be treated as having what HMRC call 'their true nature' (ie. trading or non-trading) when determining whether or not the corporate partner is a trading company.

As far as joint venture companies are concerned, the FB 2016 definition will apply for the purposes of a disposal of shares where the person making the disposal on which entrepreneurs' relief is being claimed has at least a 5% interest in the ordinary share capital of the joint venture company and effectively controls at least 5% of its voting rights. The claimant's shareholding interest and voting rights can be held directly or indirectly. For this purpose, it should be noted that fractional ownerships within a group of companies of which the investing company is a member are treated as 100%. Thus, if David holds 20% of the share capital of A Ltd which, in turn, holds 60% of the shares in B Ltd and if B Ltd holds 40% of the shares in JV Ltd (a joint venture company), David's indirect shareholding interest in JV Ltd is 20% x 100% (**not** 60%) x 40% = 8%. There are similar rules for computing David's indirect voting rights in JV Ltd. Where a corporate partnership is involved, the FB 2016 definition will apply if the person making the disposal is entitled to at least 5% of the partnership assets and profits and controls at least 5% of the voting rights in the corporate partner. For example, an individual holding 30% of a company which is a partner in a firm where the corporate partner is entitled to 25% of the firm's profits but only 10% of its assets is treated for CGT purposes as having a share of 30% x 10% (**not** 25%) = 3%. This is not sufficient to apply the 'look through' provision.

These amendments have effect in relation to disposals made on or after 18 March 2015. As HMRC say, they ensure that entrepreneurs' relief is 'better targeted at people who have a significant investment in a trading business'.

The new investors' relief

Cl 76 and Sch 14 FB 2016 introduce a new investors' relief which is intended to complement entrepreneurs' relief by extending the 10% rate of CGT to gains accruing on the disposal of qualifying shares held by investors in an unquoted trading company. In contrast to entrepreneurs' relief, there is no mandatory minimum shareholding percentage. This new relief applies in respect of qualifying shares up to a lifetime limit of £10,000,000. This limit is in addition to the £10,000,000 which is in point for entrepreneurs' relief.

Shares will qualify for investors' relief when they meet the conditions set out in S169VB(2) TCGA 1992 (as inserted by Para 2 Sch 14 FB 2016):

(i) the shares must be new ordinary shares, having been subscribed for by the investor making the disposal;

(ii) the shares must have been issued by the company on or after 17 March 2016;

(iii) the shares should have been held continuously by the investor for a three-year 'minimum period' starting on 6 April 2016 (but, where the shares were issued before 6 April 2016, this 'minimum period' is extended by the number of days from the date of the share issue up to 5 April 2016);

(iv) at the time when the shares were issued, none of the company's shares or securities should have been listed on a recognised stock exchange;

(v) the company must have been a trading company or the holding company of a trading group throughout the share-holding period; and

(vi) neither the investor nor any person connected with him should have been an officer or employee of the company (or any connected company) during the period in which shares held.

This relief will be relevant for disposals made in 2019/20 and subsequent tax years.

There are special matching rules applying to qualifying and potentially qualifying shares so as to ensure that all disposals have the best chance of meeting the three-year 'minimum period'. There are also important provisions where there has been a reorganisation or takeover for the purposes of:

(i) determining whether relief will be available for the new shareholding; and

(ii) aggregating the holding periods of both the original and new shares in certain circumstances.

And, in a similar way to the EIS anti-avoidance regime, there is legislation to deny relief where an investor has received value of more than an insignificant amount from the company. However, the receipt of reasonable interest, rent or dividends is not caught.

Contributed by Robert Jamieson

IHT and pension drawdown funds (Lecture P954 – 13.40 minutes)

S3(3) IHTA 1984 is an important anti-avoidance provision in the IHT legislation which states:

'Where the value of a person's estate is diminished and the value of another person's estate . . . is increased by the first-mentioned person's omission to exercise a right, he shall be treated for the purposes of this section as having made a disposition at the time (or latest time) when he could have exercised the right, unless it is shown that the omission was not deliberate.'

Not taking up pension rights at an age when they could be taken up was capable of being an omission to exercise a right under S3(3) IHTA 1984, given that such deferment would have the effect of increasing the death benefits going to a person other than the member of the pension scheme. This issue was resolved by FA 2011 which introduced S12(2ZA) IHTA 1984. The subsection confirms that, where a person who is a member of a registered pension scheme omits to exercise any pension rights under the scheme, S3(3) IHTA 1984 is no longer relevant in relation to that omission.

Following the flexi-access pensions regime instituted by the last Government, S12(2ZA) IHTA 1984 assumed a greater degree of importance in view of the uncertainty about its scope. One pensions expert pointed out that a number of commentators had queried the analysis of the FA 2011 measure that IHT would not apply to death benefits. He summarised their position with these words:

'S3(3) IHTA 1984 could still apply in cases where the member died, having designated his pension fund to drawdown. This was on the basis that the exemption in S12(2ZA) IHTA 1984 only applied to the member's right to elect to crystallise the plan and so draw benefits. The exemption did not apply to the member's rights to draw the funds, having gone into drawdown (ie. where the funds had already been designated to drawdown but just had not been fully drawn at the point of death).'

Illustration

Jeremy was aged 70 when he died on 1 February 2016, holding an uncrystallised pension plan (ie. he had drawn no benefits from it). While technically Jeremy has omitted to exercise a right in that he could have crystallised his plan and taken benefits during his lifetime, S12(2ZA) IHTA 1984 will provide a let-out from such a charge.

Contrast his situation with that of his cousin, Adam. Adam is aged 75. On 1 August 2015, he crystallised his pension plan, taking a 25% tax-free lump sum in cash. He designated the remaining fund to drawdown but took a nil income. He died shortly afterwards on 1 December 2015. The argument is that the exemption in S12(2ZA) IHTA 1984 cannot apply to Adam because, prior to his death, he was already in income drawdown. Accordingly, S3(3) IHTA 1984 could be in point in relation to the invested funds.

In order to deal with Adam's problem, clause 45 of the draft Finance Bill has brought in a new S12A IHTA 1984 which applies where someone has become entitled to a drawdown pension fund or to a flexi-access drawdown fund but has omitted to exercise his right to draw down all of the designated funds during his lifetime, as a result of which there are undrawn funds at the date of death.

S3(3) IHTA 1984 will not apply in these circumstances. S12A(2) IHTA 1984 lists the various types of pension arrangements which are covered by this new provision. Very sensibly, it is fully retrospective to:

- 6 April 2011 in the case of member's and dependants' drawdown pension funds; or
- 6 April 2015 in the case of flexi-access drawdown funds.

Contributed by Robert Jamieson

DOTAS and IHT planning (Lecture P955 – 9.53 minutes)

HMRC have temporarily shelved their plans to extend the DOTAS regulations in order to cover most types of IHT planning. Hitherto, the rules only caught arrangements designed to avoid an entry charge when setting up a relevant property trust.

The so-called 'draft hallmark' measures, which were published for consultation in July 2014, explained that an arrangement would in future fall under DOTAS if:

- its main purpose, or one of its main purposes, is to obtain an IHT advantage; and
- it is contrived, abnormal or unlikely to have been made if there were no tax advantage.

Arrangements made as part of the drafting of a will were explicitly excluded, but almost any other form of IHT planning – even lifetime gifts to family members – could potentially be caught.

The broad scope of these proposals drew heavy critical comments from the main professional bodies, especially in view of the fact that schemes caught by DOTAS are now subject to HMRC's accelerated payments regime which requires individuals to hand over to the tax authorities any disputed tax before a court or tribunal has ruled on the scheme's rights and wrongs.

HMRC have accepted the force of these criticisms and so the proposed IHT hallmark has been omitted from the latest revision of the DOTAS rules – see SI 2016/99. As the published summary of the consultation responses says:

'Respondents were consistent in their view that the drafting . . . goes too wide and risks catching ordinary IHT planning products that are not abusive.'

HMRC go on:

'The Government recognise these concerns. They remain committed to updating the IHT hallmark, but in a way that is tightly targeted and does not catch ordinary non-abusive tax planning.'

Note, however, that HMRC have decided to apply the 'confidentiality' and the 'premium fee' hallmarks to IHT arrangements with effect from 23 February 2016.

The Government intend to develop a revised draft IHT hallmark for further consultation in 2016.

Contributed by Robert Jamieson

Administration

Reasonable excuse for late paid PAYE

Summary - The FTT found that the school's lack of funds was a reasonable excuse for the late payment of PAYE

The taxpayer was a school that fell into financial difficulties. It paid late several of its PAYE monthly liabilities during 2012/13 and HMRC imposed penalties under Sch 56 FA 2009. The taxpayer appealed. It said it had had cash flow difficulties since the economic downturn when bad debts were created as a result of parents being unable to pay the school fees.

Decision:

The First-tier Tribunal said the economic downturn could not, on its own, be a reasonable excuse for insufficiency of funds to pay the tax. However, in 2012/13 there were two specific underlying causes for the lack of funds. First was the loss of 15 pupils from the beginning of the 2012/13 academic year, which was three times the normal attrition rate. The loss of fee income was aggravated by increased costs as a result of staff sick leave. Second, the school, as a charity, had no capacity to raise short-term finance on the open market and a promise from a benefactor depended on her own business having the funds to lend.

The tribunal said the school could not have reasonably foreseen the loss of so many pupils, but it had, as a result, decided to turn the senior school to co-educational. The judge ruled that the school had a reasonable excuse from August 2012 to March 2013 for failing to pay its PAYE tax on time. It had made the payments as soon as it could and, since a new board of directors and trustees was appointed in June 2014, all payments were made on time.

However, for the months May to July, the taxpayer did not have reasonable excuse.

The taxpayer's appeal was allowed in part.

Comments – Lack of funds has long been not a reasonable excuse as otherwise it could be claimed in many more cases. The FTT in this case however differentiated between a general lack of funds stemming from the economic downturn, which did not constitute a reasonable excuse, and a lack of funds caused by specific unforeseeable events, which was capable of constituting a reasonable excuse.

Fernhill Primary School Ltd v HMRC TC4996

Closure notice application in the absence of evidence

Summary - The FTT ordered the issue of a closure notice in the complete absence of evidence from either side.

Mr Nichols had applied for closure notices of enquiries relating to several tax years. The FTT had directed that these applications should be grouped under a single reference and heard together with Mr French's application for a closure notice.

The hearing was listed for 1 March 2016 and HMRC had tried to adduce evidence at 19:17 on 29 February. The FTT refused to admit it, as there was insufficient time for the appellants to consider it.

Decision:

S28A(6) TMA 1970 requires the tribunal to direct that a closure notice be issued within a specified period 'unless satisfied that there are reasonable grounds' for not doing so. As a result of the exclusion of HMRC's evidence, Mr Nichols and Mr French chose not to give evidence so that there was no evidence before the tribunal.

The FTT found that without any evidence there were reasonable grounds for not directing the issue of a closure notice, it must order the closure notice to be issued.

Furthermore, in the absence of evidence on the type of information still required by HMRC, the tribunal's direction could not be conditional on the production of the information.

The FTT therefore ordered that a closure notice be issued by 1 May 2016.

Comments - HMRC ignored the deadline set by the Tribunal for when it had to provide evidence. By only submitting the evidence the evening before the hearing, and not at least 14 days before the hearing as directed, it meant the evidence was not admitted.

Given HMRC's approach to compliance in this case the Tribunal judge referred to the Senior President of Tribunal's comments in his judgment in BPP Holdings Ltd v R & C Commrs in which he:

'found the approach of HMRC to compliance to be disturbing. At times it came close to arguing that HMRC, as a State agency, should be treated like a litigant in person and that the constraints of austerity on an agency like the HMRC should in some way excuse unacceptable behaviour. I remind HMRC that even in the tribunals where the flexibility of process is a hallmark of the delivery of specialist justice, a litigant in person is expected to comply with rules and orders and a State party should neither expect to nor work on the basis that it has some preferred status – it does not.'

P Nichols and C French v HMRC [2016] UKFTT 155

Discovery assessments

Summary - The Court of Appeal upheld the UT decision that a taxpayer had no right to a separate preliminary hearing to determine whether HMRC had validly made a discovery assessment

The appellant was the major shareholder in Matalan, who claimed to have become non-resident immediately before the start of the tax year in which he realised a £200m gain on the sale of his Matalan shares. HMRC raised a discovery assessment under s29 TMA 1970 on the basis that Mr Hargreaves had not taken sufficient steps to become non-resident.

Mr Hargreaves appealed against the discovery assessment on the grounds that:

1. HMRC had no power to raise the discovery assessment because the apparent underassessment was not attributable to fraudulent or negligent conduct by him or his agent (s29(4) TMA 1970) and HMRC could reasonably have been expected to know of the tax loss when the enquiry window closed (s29(5) TMA 1970) and so it was invalid ('the competence issue'); and
2. he was neither resident nor ordinarily resident in the UK in the relevant year and therefore he was not liable to capital gains tax.

Mr Hargreaves submitted that the first issue should be addressed at a separate preliminary hearing, but in the FTT Judge Gort decided not to allow a preliminary hearing. The FTT held that there was no right to a preliminary hearing and whilst it had discretion to order a preliminary trial it decided not to do so.

Mr Hargreaves appealed to the UT which confirmed the FTT's decision. The UT found that there was no basis to disturb the decision of the FTT and that the UT would in fact have reached the same conclusion.

Mr Hargeaves appealed to the Court of Appeal on the issue that he had a right to require HMRC to establish in a preliminary hearing that the discovery assessment was validly made. He was not given permission to appeal the exercise by the FTT of its discretion not to order a separate trial.

The fundamental point put forward for Mr Hargreaves was that s29(3) TMA 1970 provided a highly important protection for taxpayers and that protection would not be fulfilled unless there was a right to a separate hearing.

Mr Hargreaves submitted that the taxpayer's right to require a separate hearing on the competence issue ('the separate hearing right') formed part of a group of rights. The components of the group being:

1. the right to a separate hearing of the competence issue;
2. the right to require HMRC to begin and to force HMRC to lead evidence proving their ability to make the assessment without any aid from the taxpayer; and
3. the right to challenge the correctness of an assessment on the hearing of the substantive appeal.

Decision:

The Court of Appeal upheld the UT decision and dismissed Mr Hargreaves's appeal. Arden LJ, with whom Underhill LJ and Sales LJ agreed, judged that the tribunals had discretion to determine whether there should be a separate trial of the competence issue on which the onus of proof rested on HMRC, but that Mr Hargreaves could not establish the right to *require* a separate trial. Protection was instead provided by the FTT exercising its case management powers when the appeal was heard.

Comment - Prior to FA 1989 the issue of a discovery assessment was a two-stage process, as it required the leave of the General or Special Commissioners. This case confirms that this is not the case under current legislation. On the basis of this decision, the taxpayer will have to be prepared to address both the preliminary issue, of whether the discovery assessment was validly made, and the substantive issue, of whether the taxpayer was not resident and not ordinarily resident, in a single appeal hearing.

Hargreaves v HMRC EWCA

Back down under - Conditions for discovery

Summary - The First-tier Tribunal upheld the taxpayer's grounds of appeal, but in part only, against assessments in respect of earnings for the two tax years 2009–10 and 2010–11. The taxpayer, whilst resident, was not ordinarily resident for either of the years.

The taxpayer was an Australian citizen who was seconded to the UK in 2007. He returned to Australia in January 2011. In his 2009/10 and 2010/11 tax returns he claimed travel expenses for flights which he said were for business. He also claimed he was not resident in the UK for both years.

In September 2012, HMRC opened an enquiry into the taxpayer's returns as a result of information from his employer which suggested he had been UK-resident in both years. This resulted in a discovery assessment for 2009/10, a closure notice for 2010/11 and a penalty notice for inaccurate returns.

The taxpayer appealed, saying when the enquiry window closed for 2009/10, HMRC had enough information to open an enquiry and therefore s29(5) TMA 1970 was not met.

Decision:

The First-tier Tribunal said the taxpayer's submission was not relevant because the Revenue had only to show that one of the conditions in s 29 had been met and it chose to focus on s 29(4). The judge said it was clear from the evidence that, having received no detailed response from taxpayer about how long he had spent in the UK in 2009/10, HMRC contacted the UK Border Agency and found that the number of days that he had spent in the UK that year not only exceeded the 86 he had declared but also the 183 days necessary to make him resident in the UK for tax purposes.

This was clearly a discovery because it was information that had not been available to HMRC before.

On the travel expenses point, the tribunal said the evidence showed that the taxpayer had not been obliged by his employer to incur them. Therefore they were not allowable.

The taxpayer's appeal was dismissed pending further consideration of the penalty.

Comments - The interest in this case is the Tribunal's discussion of 'ordinary residence' and its conclusion, on the facts, that W remained not ordinarily resident for the two years in question.

R Ward v HMRC *TC4902*

Late appeal against IT assessments

Summary - The First-tier Tribunal refused a taxpayer's application to make a late appeal against income tax assessments and penalty determinations.

Mr Odunlami (the appellant) applied to be allowed to make a late appeal against closure notices, discovery assessments and penalty determinations issued as a result of an HMRC enquiry.

Decision:

The FTT approached its decision on whether to allow the appellant to make a late appeal on the basis of the principles set out in the Upper Tribunal case of Data Select Ltd v R & C Commrs in 2012. It therefore considered the questions set out by Mr Justice Morgan in that case and found as follows.

What was the purpose of the time limit?

The 30-day time limit for a taxpayer to make an appeal was to provide taxpayers and HMRC with certainty as to the 'cut off' point when the amount of tax or penalties asserted by HMRC to be due as regards a particular matter or period became certain and final. It was not a matter of routine for the tribunal to allow an appeal to be made outside of the normal time limits and the starting point had to be that the 30-day limit should usually be adhered to.

Therefore, the tribunal could only permit a late appeal if it was satisfied that on balancing all relevant factors (the length of the delay, the reason for the delay and the effects on the parties of granting or not granting the application for the late appeal), it would be unjust and unfair not to do so.

How long was the delay?

The notice of appeal was submitted to the tribunal over two years after the time limit. Although the appellant raised objections before then to the assessments and determinations and there had been correspondence between the appellant and HMRC during the intervening years, there was nothing material until well over a year after the assessments and determinations were raised.

Was there a good explanation for the delay?

The reason put forward for the delay by the appellant's representative was that the appellant was suffering from a mysterious illness and that his previous advisers had gone into liquidation, leaving his affairs and records in disarray. Given the lack of evidence the FTT was unable to conclude that there was a good explanation for any of the periods of delay.

What would be the consequences for the parties of an extension of time or a refusal to extend the time?

The FTT followed the approach in the UT case of O'Flaherty v R & C Commrs in 2013 and considered whether the appellant's appeal would have any reasonable prospect of success, if the appellant were to be allowed to make a late appeal to the tribunal. The main basis of the assertion that the assessments were excessive was that funds should be excluded from the appellant's taxable income as they were loans made to the appellant or other amounts which did not form part of the appellant's taxable income. In this regard, the FTT found the evidence to be not very substantial and in many respects wholly inconclusive. In all the circumstances, given the amount of time that has elapsed, the limited and inadequate nature of information and evidence produced during a prolonged period of correspondence as to the correct level of taxable profits, the lack of credibility of the information given and the delay in coming forward with it, the FTT did not consider that the appellant's appeal would have any reasonable prospect of success.

The FTT also noted that if the time limit were to be extended, HMRC would face the prospect of dealing with a matter which they would have regarded as closed several years ago with the inherent difficulties the time delay brings.

Taking into account the considerable delays by the appellant in making an appeal, the absence of any credible reason for the delay in the making the appeal, the absence of credible submissions and evidence indicating that the assessments and determinations could be successfully appealed against, the potential difficulties in the conduct of the case for HMRC given that they had considered the matter final several years ago and the interests of ensuring finality in such matters, the FTT refused the appellant's application for permission to appeal against the assessments and determinations outside the statutory time limits.

Comments - The FTT noted that it was bound to follow decisions of the UT but where there were conflicting decisions of the UT, the FTT was free to decide which decision to follow. The FTT in this case decided to follow Judge Bishopp's comments in Leeds City Council v R & C Commrs , that it was correct to follow the principles in the *Data Select* case.

Odunlami v HMRC TC4786

Had a tax adviser been negligent?

Summary - The High Court found that a firm of solicitors which had recommended a tax avoidance scheme, that had failed, was not liable for professional negligence.

Mr Barker claimed professional negligence against his solicitor for advice on a tax avoidance scheme based on the establishment of an employee benefit trust which he had entered into and which, if successful, would have avoided CGT and IHT. HMRC had challenged the scheme. Mr Barker, having been advised that HMRC was likely to succeed, had entered into a settlement involving the payment of a substantial amount on account of tax and interest.

Mr Barker claimed that he could have entered into another scheme, which would have been successful. He contended that he had been advised that the structure set up would satisfy the requirements for an EBT if his wife and children were excluded during his lifetime but that they could benefit after his death, whereas they had to be excluded completely. In any event, there had been a sufficient possibility of this alternative construction for his solicitor to warn him of the risks.

The court observed that 'the relevant question was whether a reasonably competent specialist tax lawyer at the time, with particular expertise in tax avoidance schemes, applying proper skill and care, could have advised as these defendants did regarding the EBT scheme'. The fact that other tax advisers may take a different view or that the statutory interpretation was eventually found to be wrong by the tax tribunals did not establish negligence.

Although the court accepted that Mr Barker's solicitor's interpretation of the relevant provisions had been reasonable, it found that the solicitor had breached its duty of care by not giving his client a 'general health warning' about the inherent risks of implementing a tax avoidance scheme. However, the court also found that such a warning would not have deterred Mr Barker, since he had known that this was an aggressive scheme and his case was that he would have entered into another scheme had he known that the EBT scheme may not succeed. The breach had therefore not caused the loss incurred.

Finally, the court rejected the contention that Mr Barker's solicitor should have given him a 'high level warning' on the significant risk of the EBT scheme. A solicitor whose interpretation was likely to be correct could not be in breach of duty for failing to warn his client that he might be wrong.

Comments - The solicitors had contended that the standard applicable was less than that for a tax QC. The court found, however, that as they had given advice on the EBT scheme without the help of a tax QC, there was no difference and they had to be held to a high standard. They had therefore breached their duty of care but their breach was not the cause of the loss.

Ian Barker v Baxendale Walker Solicitors and Paul Baxendale-Walker [2016] EWHC 664

Time limits for enquiries into repayment claims

Summary – The First Tier Tribunal allowed Mr Corrigan's appeal against HMRC's refusal to issue a VAT repayment supplement

Mr Corrigan was appealing HMRC's decision to refuse to pay a repayment supplement. A repayment supplement is a form of compensation paid in certain circumstances, when HMRC does not authorise payment of a legitimate claim within 30 days of the receipt of a VAT return. For this purpose, time taken for HMRC's enquiries can be left out of account (s79((3) & (4) VATA 1994).

It was agreed that the 30 day period had started on 30 June 2013 and ended on either 5 or 8 August 2013. HMRC had written to the taxpayer on 16 July, informing him that it intended to visit its premises on 30 July in order to check the 'repayment return for the period 5/13 and to examine the records that relate to this return'. The issue was whether the period from Tuesday 16 July 2013 to Tuesday 30 July 2013, reduced by four days by HMRC, should be left out of account in calculating the 30 day period.

Decision:

Referring to *Marlico* [2015] UKFTT 528, the FTT noted that the legislation refers to a specific inquiry, being the 'reasonable inquiry relating to the requisite return' and requires HMRC to have identified more than a general need for information. It added that the letter from HMRC dated 16 July 2013 identified only a general need for information and simply indicated that HMRC was to visit the taxpayer's premises. It did not ask a specific question which needed to be answered.

The FTT concluded that the inquiry had begun and ended on 30 July 2013, the day of the visit to the taxpayer's premises. Accordingly, the relevant period was 36 days, or alternatively 39 days. Both of these periods exceeded 30 days and consequently HMRC was liable to pay the repayment supplement.

Comments - In this case, Mr Corrigan submitted a VAT repayment claim which took HMRC 40 days to process, during which time a VAT visit was carried out to enquire into the claim.

HMRC refused to issue a repayment supplement on the basis that the repayment was issued within 30 days once the 18 days between arranging a VAT visit and authorising the repayment was deducted from the 40 day period (as permitted by SI 1995/2518, reg. 198).

The FTT allowed the appeal ruling that the period spent on dealing with *the raising and answering of any reasonable inquiry* deductible from the repayment period extended to just the one day on which the VAT visit took place.

Corrigan v HMRC TC 4966

Successful application for hardship

Summary - The First-tier Tribunal allowed the application by the appellant for relief from the requirement to pay a disputed VAT assessment pending appeal as they were satisfied that to pay the tax demanded in the light of all the circumstances would cause the appellant hardship.

HMRC had written to Elbrook informing it that it was denying credit for input tax of £771,430.20 for the five consecutive periods from 01/13 to 04/14 inclusive, on the ground that the company had allegedly participated in MTIC fraud. Elbrook Cash & Carry Ltd (the appellant) appealed to the Tribunal and also sought relief from any requirement to pay or deposit the tax assessed on the grounds of hardship.

HMRC then cancelled the appellant’s authorisation under the *Warehouse-keepers and Owners of Warehoused Goods Regulations* 1999 (WOWGR).

The FTT were required to determine the application for relief from payment of the disputed tax only.

Decision:

The FTT noted that the appeal was in relation to HMRC requiring payment of the disputed VAT before any appeal would be entertained, unless either HMRC were satisfied, or the Tribunal decided, that payment of the disputed VAT would cause the appellant to suffer hardship.

The appellant argued that financial information showed that its net profit had fallen by 79.2% per the latest available accounts and none of its fixed assets were liquid.
The balance in its bank account was needed to trade and stay solvent and although the appellant could have approached its bank for an increased facility, it did not because it was feared that this would not

only be refused but that it would lead to a pulling of the plug by the bank. The appellant did, however, approach other bankers.

The FTT expressed their view that an application of this sort should not require the Tribunal carry out a lengthy forensic analysis of financial material and that Dr Avery's comments in Buyco Ltd; Sellco Ltd in 2007 applied: hardship meant the business being harmed and if the cash was not available, meaning the business would be harmed by having to pay the tax, what further steps should be taken to raise the cash in order to avoid suffering hardship? In this respect, if a business' normal bankers would not lend, it should not be required to pursue other sources of finance simply in order to pay the tax and it should further not be required to sell assets purchased for business use, whether those assets were currently being used in the business or not.

The FTT were mindful not to stifle a meritorious appeal and considered that the present appeal was neither frivolous nor designed to delay the inevitable payment of tax.

Therefore, the FTT found that they did not need to consider whether the appellant could sell fixed assets to raise the funds and that it did need its existing cash float for its trading operations. This suggested that payment would cause financial hardship especially given the effect of the HMRC action on its bonded warehouse operations that undoubtedly caused a reputational and accordingly a financial loss in its other activities.
The appellant had already exhausted its existing banking facilities and to approach its bankers for additional funds when it had had its WOWGR authorisation cancelled and been given a large VAT bill on a basis consistent with its participation to some degree in an MTIC-type fraud could well have caused its bankers to panic.

In conclusion, the FTT were entirely satisfied that, on the balance of probabilities, to pay the tax demanded in the light of all the circumstances, especially the actions of HMRC in cancelling the WOWGR authorisation, would cause the appellant hardship. The application was allowed.

Comments - The FTT found that the appellant's existing cash balance was required to fund trading operations; it was not required to sell fixed assets in order to raise finance; it had exhausted its existing banking facilities and could not be expected to approach its bankers for additional funds given that not only was it likely that any such application would be refused but to do so would also risk the bank pulling the plug on existing facilities. Accordingly, the FTT found that to pay the tax demanded in the circumstances would cause hardship and the application was allowed.

Elbrook Cash & Carry v HMRC TC4976

Judicial review claim for APN

Summary - The High Court rejected a claim for judicial review of an advance payment notice.

Dr Walapu had implemented a tax avoidance scheme marketed by the Mercury Tax Group and known as Liberty Syndicate 21. He sought judicial review of HMRC's decision to issue an APN. He had claimed relief against past income tax assessments in his tax return but he had not yet had his claim formally assessed. He accordingly submitted that the APN required the payment on account of an unassessed tax liability that had not yet accrued. This case therefore differed from *Rowe v HMRC* [2015] EWHC 2293 in which HMRC had formerly assessed the liability.

Decision:

The High Court first observed that the new arrangements pursued a legitimate objective, were targeted precisely upon the class of persons who engaged in the activity sought to be suppressed, and incorporated a vigorous process whereby the APN was likely to correlate to the actual tax position. The court then proceeded to reject each of Dr Walapu's arguments. It found that:

1. The rules did confer a right of representation since they created a statutory right of consultation which took effect, not before the issue of the APN but before it became effective.

2. There had been no violation of Dr Walapu's legitimate expectation nor of the principle of non-retroactivity. The court, in particular, rejected the claimant's contention that HMRC had been quiescent following the submission of the return leading the claimant to assume that no APN would be issued. HMRC had made its intention to challenge the scheme very clear from the outset. Furthermore, FA 2014 was retroactive only in the sense that it had changed the payment rules and its retroactivity, which operated at the very lowest point of severity, was justified in the context of its objective of fighting tax avoidance.

3. The claimant had not been denied access to a court in breach of the European Convention of Human Rights article 6. The dispute was not 'civil' and, in any event, there had been no violation since judicial review was available and the claimant could compel HMRC to make an assessment, which would create a right of appeal.

4. There had been no violation of the claimant's property rights (enshrined in the European Convention of Human Rights article 1 protocol 1) since a dispute about tax took it out of the notion of 'possession' and there was no deprivation as the monies would be returned if the claimant won the case.

5. The scheme had been a 'subsequent iteration of the partnership scheme', which had already been notified. This iteration did not need to be notified but it brought the scheme within DOTAS so that HMRC had had the power to issue an APN.

Comments - The court robustly rejected the notion that to require a citizen to pay to HMRC a sum which was not a sum assessed for tax constituted a profound violation of the citizen's private rights. Consistently with its earlier decision in *Rowe*, it also rejected all arguments pertaining to the validity of the legislative scheme as well as arguments specific to Dr Walapu's case**.**

Dr Walapu v HMRC [2016] EWHC 658

Tackling tax evasion: legislation and guidance for a corporate offence of failure to prevent the criminal facilitation of tax evasion

A consultation document was issued on 17 April 2016 with a closing date of 10 July 2016.

This consultation considers draft legislation and guidance for the new corporate criminal offence of failure to prevent the criminal facilitation of tax evasion, as outlined in HMRC's response document of 9 December 2015.

The new corporate offence aims to overcome the difficulties in attributing criminal liability to corporations for the criminal acts of those who act on their behalf. Whilst this consultation refers to the application of the new offence to "corporations", the draft legislation refers to a "relevant body" to encompass the broad range of legal persons to which the new offence will apply.

Attributing criminal liability to a corporation normally requires prosecutors to show that the most senior members of the corporation were involved in and aware of the illegal activity, typically those at the Board of Directors level. This has a number of impacts:

1. In large multinational organisations decision making is often decentralised and may be taken at a level lower than that of the Board of Directors, with the effect that the corporation can be shielded from criminal liability. This also makes it harder to hold such organisations to account compared to a smaller organisation where decision making is centralised.

2. The existing law can act as an incentive for the most senior members of a corporation to turn a blind eye to the criminal acts of its representatives in order to shield the corporation from criminal liability.

3. The existing law can act as a disincentive for internal reporting of suspected illegal activity to the most senior members of the corporation.

The cumulative effect is an environment that does not foster corporate monitoring and self-reporting of criminal activity. The criminal law currently renders corporations that refrain from implementing good corporate governance and strong reporting procedures hard to prosecute, and offers no incentive to invest in such procedures. It is those corporations that deliberately turn a blind eye to wrongdoing and preserve their ignorance of criminality within their organisation that the current criminal law most advantages.

Areas for consultation

A The offence

The offence as outlined in the consultation response document will have three stages:

Stage one: criminal tax evasion by a taxpayer (either a legal or natural person) under the existing criminal law (for example an offence of cheating the public revenue, or fraudulently evading the liability to pay VAT);

Stage two: criminal facilitation of this offence by a person acting on behalf of the corporation, whether by taking steps with a view to: being knowingly concerned in; or aiding, abetting, counselling, or procuring the tax evasion by the taxpayer;

Stage three: the corporation's failure to take reasonable steps to prevent those who acted on its behalf from committing the criminal act outlined at stage two.

B Those for whom a corporation can be liable

The draft legislation simply requires that the facilitation be done by a person acting in the capacity of a person associated with the corporation, defined as "someone acting on its behalf".

C Definition of a corporation

The response document stated that the Government intended the new offence to apply to all legal persons, e.g. companies, partnerships, LLPs, regardless of whether they operate commercially or for other reasons (such as charity). We continue to use the word "corporation" as a convenient shorthand when speaking of those entities which can be subject to the offence.

D The aspects of non-compliance covered by the offences

Evasion of UK taxes - The response document stated that the Government believes that corporations should be liable for failing to prevent the criminal facilitation of tax evasion (whatever the tax) by those who act on its behalf. The new offence will be committed by a corporation where it fails to prevent an associated person criminally facilitating the evasion of a tax, and this will be the case whether the undeclared funds are in or outside the UK.

The response document stated that a criminal offence will have to have been committed at the taxpayer level, and that this offence must have been criminally facilitated by a person acting on behalf of the corporation.

E Overseas tax fraud corporate offence

The consultation response document outlined the Government's intention to introduce an offence which applied in three situations:

1. Where a UK based corporation fails to prevent those who act on its behalf from criminally facilitating a UK tax loss;

2. Where a non-UK based corporation fails to prevent those who act on its behalf from criminally facilitating a UK tax loss;

3. Where a UK based corporation fails to prevent those who act on its behalf from criminally facilitating a tax loss overseas, where the jurisdiction suffering the tax loss has laws in place equivalent to those in the UK, i.e. where there is dual criminality.

The consultation document stated that the Government believes that corporations with a presence in the UK should be obliged to take reasonable steps to prevent their agents being complicit in criminal tax evasion, wherever that tax is owed. The consultation also stated that if the evasion of tax is a crime in the foreign jurisdiction then corporations should take reasonable steps to prevent their agents becoming complicit in the criminal evasion of those taxes. Section F examines the territorial scope.

Draft guidance is also included in the consultation document.

Deadline Dates

1 May 2016

- Due date of payment of corporation tax liabilities for accounting periods ended 31 July 2015 for small and medium-sized companies not liable to pay by instalments.
- From this date £10 daily penalties apply to late online self-assessment tax returns for the year ended 5 April 2015 to a maximum of £900.
- New VAT fuel scale charges apply from this date.

3 May 2016

- Filing date for form P46(Car) for quarter ended 5 April 2016.

7 May 2016

- Due date for electronic filing and payment of VAT liability for quarter ended 31 March 2016.

14 May 2016

- Quarterly corporation tax instalment for large companies (depending on accounting year end) due.
- Filing date for EC sales list for quarter ended 31 March 2016 due (paper form).

19 May 2016

- Due date of payment of PAYE/NIC/construction industry scheme/student loan payment liabilities for month ended 5 May 2016 if not paying electronically.
- File monthly construction industry scheme return by this date.

21 May 2016

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

22 May 2016

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

31 May 2016

- Employees at 5 April 2016 and from whose pay tax was deducted should have received form P60 from their employers by this date.
- The date by which Companies House should have received accounts of private companies with 31 August 2015 year end.
- Companies House should have received accounts of public limited companies with 31 November 2015 year end by this date.
- By this date HMRC should have received corporation tax self-assessment returns for companies with accounting periods ended 31 May 2015.

HMRC News

HMRC's response to the ICIJ story on offshore tax evasion

Jennie Granger, Director General of Enforcement and Compliance, HM Revenue and Customs, said:

> HMRC is committed to exposing and acting on financial wrongdoing and we relentlessly pursue tax evaders to ensure that they pay every penny of taxes and fines they owe.
>
> HMRC can confirm that we have already received a great deal of information on offshore companies, including in Panama, from a wide range of sources, which is currently the subject of intensive investigation. We have asked the ICIJ to share the leaked data that they have obtained with us. We will closely examine this data and will act on it swiftly and appropriately.
>
> We have brought in more than £2 billion from offshore tax evaders since 2010 and the Government has repeatedly strengthened our powers and resources with new criminal offences and higher penalties, so we can take even tougher action against the minority who try to cheat the honest majority by hiding their money in offshore tax havens.
>
> Our message is clear: there are no safe havens for tax evaders and no-one should be in any doubt that the days of hiding money offshore are gone. The dishonest minority, who can most afford it, must pay their legal share of tax, like the honest majority already does.

Additional information on offshore tax evasion

HMRC has a great deal of information on offshore companies, gathered from a wide range of sources and intelligence, and is following up thousands of leads on potential offshore evasion at any one time. We have brought in more than £2 billion from offshore tax evaders since 2010.

We have asked the International Consortium of Investigative Journalists, theBBC and The Guardian to share their data with us, so we can cross-reference it with 'Connect', our own world-leading database of intelligence, to see if it adds to the 700 current leads we already have with a link to Panama. We will closely examine this data and will act on it swiftly and appropriately, where we suspect that UK tax has been evaded.

The data we receive and the leads we are pursuing will not necessarily prove wrongdoing and result in fines or convictions. Such data is often incomplete or years out-of-date or does not contain the information required to identify individuals. But it can help build up a bigger picture which allows us to join the dots and catch tax evaders.

HMRC is committed to exposing and acting on financial wrongdoing and we relentlessly pursue tax evaders to ensure that they pay every penny of taxes and fines they owe.

The specialist offshore unit in our Fraud Investigation Service is currently investigating more than 1,100 cases of offshore evasion around the world, with more than 90 individuals subject to current criminal investigation.

The Government has repeatedly strengthened our powers and resources with new criminal offences and higher penalties, so we can take even tougher action against the tiny minority who try to cheat the honest majority by hiding their money in offshore tax havens.

Our message is clear: there are no safe havens for tax evaders and no-one should be in any doubt that the days of hiding money offshore are gone. The dishonest minority, who can most afford it, must pay their legal share of tax, like the honest majority already does.

New powers and action against offshore tax evasion

The Government has led a transformation in global financial transparency which, from this year, will see HMRC automatically receive offshore account and trust data from more than 90 countries, including British Overseas Territories and Crown Dependencies with a financial centre. This will further increase HMRC's ability to crack down on the tiny minority of tax cheats still hiding their money offshore.

The Government has introduced tough new powers and game-changing measures to tackle offshore and onshore tax evasion, and as recently as the summer Budget 2015 gave HMRC an additional £800 million to invest in compliance and tax evasion work.

This is expected to recover £7.2 billion in tax over the next five years and includes tripling the number of criminal investigations that HMRC can undertake into serious and complex tax crime, focusing particularly on wealthy individuals and corporates, with the aim of achieving 100 prosecutions a year by the end of the Parliament.

The new measures include:

- higher financial penalties for those hiding assets offshore, such as, for the first time, taking part of the evaded asset as a penalty. These are in addition to existing measures, which already allow for fines of up to 300% of any tax found to have been hidden offshore
- new civil penalties on those who enable tax evasion, so they will face a penalty as well as the tax evader
- public naming both of tax evaders and those who enable tax evasion
- a new criminal offence for corporations that fail to prevent the facilitation of tax evasion. The new power, which is being legislated for shortly, will ensure that corporations exercise due diligence over the service they provide, and ensure that HMRC can prosecute those who don't
- a new strict liability criminal offence for offshore evasion, which we are currently legislating for – so in the worst cases it is no longer possible to plead ignorance in an attempt to avoid criminal prosecution.

We have also ended permanent non-dom status from April 2017, and ensured that inheritance tax will be levied on all UK residential property, regardless of its holding structure.

Data on tax evasion

Data from third parties is an important part of our intelligence. Last year,HMRC received 86,000 separate leads, ranging from local concerns to intelligence that helps us take down criminal gangs.

We also gathered around 100 million items of data through a combination of intelligence gathering, bulk data and our own expert investigations.

All of this information is linked and cross referenced to other data, using some of the most sophisticated computer systems in the world, to build up a picture that can lead to tough action against those who seek to cheat their taxes. Where we find an allegation or dataset that clearly demonstrates or corroborates non-compliance, we won't hesitate to act.

HMRC welcomes information from members of the public who suspect or have evidence of tax evasion, and in some instances they may be eligible for a financial reward. The Tax Evasion Hotline number is 0800 788 887.

HMRC's successes in tackling tax evasion

In 2014-15 alone, HMRC collected and secured £26.6 billion from compliance activities, including from tax evasion, avoidance, fraud and organised crime – a 43% increase from £18.6 billion in 2011-12.

HMRC has:

- brought in more than £2 billion from offshore disclosures and other offshore tax evasion initiatives since 2010
- protected more than £6 billion through criminal investigations since 2010, with 2,647 convictions and prison sentences totalling 3,125 years
- launched more than 140 taskforces in high-risk sectors, including illegal alcohol and tobacco sales, recovering more than £0.5 billion in additional revenue since 2011
- collected more than £1.5 billion in additional tax revenue from the UK's wealthiest people through our High Net Worth Unit since its creation in 2009
- secured more than £38 billion as a result of our compliance work with large businesses during the last Parliament
- overseen a reduction in the UK tax gap (the gap between tax owed and tax paid) to 6.4% – its lowest-ever level and one of the lowest in the world.

Business Taxation

Fixed Rate deductions for use of home (B951 – 13.07 minutes)

Three changes relating to partnerships are contained in the current Finance Bill and deal with Fixed Rate deductions for use of home. The measures are contained in clause 24, and the changes announced come into effect for 2016 -17 and following years subject of course to any changes before the Finance Act is enacted in July. The main rules are contained in schedule 5 FA2013 from 6 April 2013. Schedule 5 is an optional method of claiming tax relief in the case of three specific expenses categories - it does not have general application.

Fixed rate deductions were introduced alongside cash accounting (schedule 4) but the two schemes are independent of each other: each business has the choice of fixed rate deduction or cash accounting, or both, or indeed neither. The choice is there. Also, unlike cash accounting, the fixed rate scheme may be used by unincorporated businesses of any size so no turnover test. See BIM75000 for more details.

Unincorporated businesses

Which type of business may use the scheme? The answer is an unincorporated one - so a sole trader or partnership but (as with AIAs) the partnership must consist wholly of individuals so corporate partnerships are excluded. LLPs are excluded from the scheme because they are of course incorporated not unincorporated.

Hours worked

Claims are based on one measure only, that of how many hours in a particular month the sole trader or partner worked for the purpose of the trade including hours worked by any employee of the business). This is simple and a lot more straightforward than the alternative standard deduction which looks at a multiplicity of factors such as numbers of rooms, actual fixed and variable costs and hours worked. See BIM 47800 onwards for more details

Choice of claims

Is a claim worth it? The answer requires a comparison of the alternative methods available.

For a sole trader working 101+ hours per month in each of 12 months the maximum annual claim is £312. Measuring that against the example of an average home owing sole trader client this I would say is probably around only 50% or possibly less of the figure that could be claimed by the standard method.

The trouble with the standard method is that is it very time consuming to collate the backing information regarding household costs and use …… that inevitably leads to a higher fee for the client and/or a reduced time recovery for the accountant. Preferable perhaps to opt for the simpler and quicker fixed cost alternative?

The changes

These are:

1. Where work is undertaken by more than one individual in the home, then any hour spent for the purposes of the trade is counted only once;

2. When a firm makes a claim to use a simplified expense deduction for a partner's home, it must consistently use the same rules for deductions for all partners' homes; and
3. Where an sole trader or partner in partnership used more than one premises for business purposes, then any claim to use the scheme must be applied to all such premises

New clients and changing methods

There are nearly 3 million home based businesses operating in the UK today, and this figure is expected to double in the next 20 to 30 years so there will be more clients coming along in future years for whom we will need to establish a claim.

Generally an analysis of household costs, premises used, and hours worked will tell us which of the methods to use and while that may be the basis for a useful starting point it is not the permanent answer to a tricky question while the business continues.

For example, hours worked may increase or decrease for a variety of reasons, or there might follow a move to a larger or smaller house. These factors besides many others will influence the calculation.

Digital Tax Accounting (DTA) from 2018

My last point concerns the proposed commencement of DTA beginning 2018.HMRC as part of this process will be keen to 'push' the idea of clients submitting information without recourse to the accountant and as part of this campaign encourage the use of cash accounting and fixed rate expenses on the grounds that they are easy to use. Not much mention of the standard method we can be sure!

We could even see cash accounting and/or fixed rate expenses being imposed on a compulsory basis for new small business start ups from a particular date after 2018.

We will shortly be living in interesting but very different tax times under DTA!

Contributed by Brian Ogilvie

Incorporations post April 2016 (Lecture B952 – 17.26 minutes)

The removal of entrepreneurs' relief poses a planning issue for clients who wish or need to incorporate their businesses. Paying capital gains tax at the 2016/17 full rate of 20% on the disposal of goodwill (which must be valued at market value for the related party disposal) may serve to rob the business of available working capital and thus jeopardise its survival. Incorporation is certainly an important step in a business that seeks to continue to grow, allowing profits retained in the business for growth to be taxed at a lower rate, and providing flexibility about ownership and raising finance which is not available to the unincorporated business.

Before we consider the various routes of incorporation it is worth recapping on the 0% starting rate for interest and the new personal savings allowance. Both will factor in full value incorporations.

A 0% starting rate applies for interest income, but only where taxable non-savings income is less than £5,000. Non-savings income includes employment income, trading income, property income and trust income.

Dividends are not treated as non-savings income and will not affect the availability of the £5,000 0% starting rate.

Where taxable non-savings income is less than £5,000 and the taxpayer has some interest:

1. The taxable non-savings income (if any) is taxed at 20%; and

2. The difference between the taxable non-savings income and £5,000 is taxed at 0%.

Note that where interest income falls in the 0% starting rate band there is no tax liability on the income. However, the income must still be included as taxable interest income in the income tax computation.

In 2016/17 we also have the introduction of the personal savings allowance that creates a 0% rate of tax on interest up to £1,000 for basic rate taxpayers or £500 for higher rate taxpayers.

Any interest income thereafter is taxed at 20%, 40% or 45% as normal.

If the business is to incorporate there are three possible scenarios to consider:

- Pay capital gains tax at full rates, introducing goodwill into the company at full market value in exchange for a credit to the directors' loan account.
- Shelter the capital gain using relief for incorporation under TCGA 1992 s 162.
- Shelter the capital gain using hold over relief for gifts of business assets under TCGA 1992, s 165.

Each of these will now be considered in turn, using a goodwill value of £100,000. Only the gain on goodwill is considered; there may also be a property to consider, but frequently the owner will prefer to retain the property in private ownership, so no further consideration is given to the potential tax charge in relation to the disposal of the property

Option 1: Pay CGT at normal rates on goodwill

The disposer would be liable to capital gains tax at 10% and 20%, depending on his income. However, his plan might be that he will thus create a loan account in the company on which he can draw, in preference to drawing taxable income such as salary and dividend.

If the disposer is a higher rate taxpayer (likely in the final period of trade as a successful business ready to incorporate) the tax on the disposal of the goodwill will be £17,780 (18% effective rate) assuming that the annual exempt amount of £11,100 is fully available to him. This provides a loan account balance of £100,000 for him to draw against.

He will then draw income to the extent that the marginal rate is less than 18%. In 2016/17 that would indicate drawing a salary of around £8,000 (below the NI threshold), interest at 9% on his loan account, giving £9,000 which is tax free (£3,000 within the personal allowance, £1,000 personal savings allowance and £5,000 attracting the savings starting rate of zero) and dividends of £5,000 which are also tax free. This provides him with £22,000 after tax.

Further dividends can be drawn within the basic rate band as they suffer tax of only 7.5% in addition to the corporation tax which will be paid in any event. Once dividends reach a total of £26,000 (total income £43,000) the director would switch and draw from his loan account, rather than bear tax at 32.5% on any additional dividends.

Illustration

The profits needed to generate dividends of £26,000 in the circumstances set out above are £49,500. This will bear tax as follows:

	£	£
Profit		49,500
Interest on loan account	9,000	
Salary	8,000	17,000
Taxable profit		32,500
Corporation tax at 20%		6,500
Net profit (= dividend)		26,000
Personal tax computation		
Salary		8,000
Interest		9,000
Dividends		26,000
Total income		43,000
Less personal allowance		(11,000)
Taxable income		32,000
Personal savings allowance at 0% on	1,000	-
Tax on interest at 0% on	5,000	-
Tax on dividends at 0% on	5,000	-
Tax on dividends at 7.5% on	21,000	1,575
	32,000	
Plus corporation tax		6,500
Total tax borne on £49,750		8,075
Effective rate (£8,075/£49,500 x 100)		16.3%

The 18% "one-off" charge on the sale of the goodwill to the company will give the OMB access to an annual rate of 16.3% on £49,500 profit. This seems a fair price to pay to access such a low annual rate of tax. Further savings could be enjoyed if spouses held some of the shares which would then allow both spouses to utilise their £5,000 dividend allowance and their 7.5% basic dividend band.

The key to these low tax rates would be the existence of saleable goodwill. Without the loan account (which facilitates the interest charge), but with the same profits, the tax charge would be as follows:

	£	£
Profit		49,500
Salary		8,000
Taxable profit		41,500
Corporation tax at 20%		8,300
Net profit (= dividend)		33,200
Personal tax computation		
Salary		8,000
Dividends		33,200
Total income		41,200
Less personal allowance		(11,000)
Taxable income		30,200
Tax on dividends at 0% on	5,000	-
Tax on dividends at 7.5% on	25,200	1,890
	30,200	
Plus corporation tax		8,300
Total tax borne on £49,750		10,190
Effective rate (10,190/49,500 x 100)		20.6%

So the ability to charge interest does permit a significant reduction in the tax charge on profits, but in practice, only looking at the detailed figures, including the value of the goodwill, the anticipated level of profit and the client's desired level of income can indicate whether this is an appropriate route to take.

Although we have become used to challenges to the value of goodwill, one might expect that if tax is to be collected at 20% on the value, HMRC will welcome over-optimistic valuations. However, as illustrated here, there is still a significant advantage to those with very profitable companies in setting a high value to goodwill in spite of the tax liability it creates. It is likely, therefore that HMRC will still look carefully at goodwill valuations.

Option 2: Incorporation relief under TCGA s.162

This relief has been rarely used for many years, but may now see a resurgence as a result of the changes. However, in many situations the conditions associated with the relief make it somewhat impractical to use.

Conditions for the relief

- All of the assets of the business other than cash are transferred to the company.
- Business is transferred as a going concern to the company which carries on the trade.
- The transfer is wholly or partly in exchange for shares.

Where the conditions are met relief is given by rolling the gains on the chargeable business assets (in this case the goodwill) into the base cost of the shares, therefore inflating the gain on eventual sale. If any part of the consideration is given as cash (or loan account) this produces a gain at the time of transfer, the balance of the gain being rolled over. The amount chargeable in this case is the proportion of the gain represented by cash as a proportion of the total consideration. The assets are treated as acquired by the company at market value for the purposes of subsequent disposal. The attractive proposition with this option is that if the shares are subsequently sold, the full gain will attract entrepreneurs' relief, thus effectively re-instating the relief on the gain related to the disposal of the goodwill.

Example – S162 relief in action

The goodwill is valued at £100,000. There is no property in the business. The value of non-chargeable assets such as tangible fixed assets, stock and debtors is £50,000. The mechanism of the relief is as follows:

	£
Total value of assets transferred	
Fixed and current assets	50,000
Goodwill	100,000
	150,000
Shares issued: 10,000 £1 shares @ £15.00	£150,000
Less gain rolled over	(£100,000)
Base cost of shares for future disposal	£50,000

Alternatively, if a loan account credit is to be created for 25% of the proceeds (amount to the credit of loan account is £37,500):

Shares issued: 10,000 shares @ £11.25	112,500
Gain rolled over (75%)	(75,000)
Base cost of shares for future disposal	£37,500
Gain immediately chargeable (25%)	£25,000
Tax liability at 20% (after annual exemption)	£2,780 (11.12%)

Onward sale

If the shares acquired above are subsequently disposed of under circumstances where entrepreneurs' relief will apply, the following applies:

Sales price of shares (say) £20 per share	200,000
Less base cost	(50,000)
Chargeable gain	£150,000

This gain will be charged at 10%, and comprises the gain on the goodwill resurfacing of £100,000 plus the uplift in value since incorporation of £50,000.

Practical issues

The key disadvantage of this relief is that **all** of the assets of the business must be transferred in order for the relief to apply. This means that debtors must be transferred under deed, and if there is a business property, the owner has no option but to transfer it into the company. While this serves well if the company is to continue to own premises in the long term, clients may be reluctant for a variety of reasons to put this property into the company.

Option 3: Holdover Relief under TCGA s.165

This relief applies to disposals of chargeable assets used in the trade where the disposal is not an arm's length transaction. It is commonly used in the transfer of a business to a company, as it allows the retention of the debtors and creditors by the trader who will then "clear down" the balance sheet of the trade and allow the company to start up with a clean sheet. It will also allow the trader to retain any property used in the business, which may be necessary if borrowings are secured over it.

The transfer may be made for no cash consideration at all – in which case the company acquires the asset at the disposer's base cost, or for some cash consideration. In the latter case only the gain in excess of the cash consideration can be rolled over.

The effect of the relief is therefore to reduce the base cost of the asset in the company. Here, the liability for tax on the eventual disposal has passed with the asset to the new owner, whereas incorporation relief leaves the tax liability on the gains with the original disposer. The condition for relief is that the asset has been used in the trade throughout its period of ownership by the transferor. The impact of the relief is as follows;

Example – s 165 relief in action

If the goodwill is transferred for no cash proceeds, the transaction works as follows:

	£
Value of goodwill (gain)	100,000
Less held over	(100,000)
Chargeable amount	NIL
Base cost to the company	NIL

If cash proceeds are included (as a credit to the director's loan account):

	£	£
Value of goodwill (gain)		100,000
Held over gain : full amount	100,000	
Less paid in cash	(25,000)	
Net held over gain		(75,000)
Chargeable amount		£25,000
Tax liability (as above)		£2,780 (11.12%)
Base cost to the company		£25,000

As can be seen, by combining cash consideration and triggering a partial gain, the disposer and his adviser have adequate opportunity to plan for the best possible outcome, particularly after taking into account the benefits of having at least some credit on the loan account to enable interest to be paid to the director and income based drawings to be managed. This is particularly relevant where the disposer has some basic rate band available in the year of disposal, reducing at least part of the tax charge to 10%, or indeed capital losses to be used.

However, transferring a capital gain into a company, where if it is to be realised as funds in the taxpayer's hands is not a sensible option. Tax will be borne twice to turn the proceeds into cash in the hands of the owner. For some owners, the additional corporation tax on the disposal of the goodwill presents an unattractive outcome for onward sale. It is fair to say that if the business is disposed of subsequently, purchasers are still more likely to opt to purchase assets rather than shares (in spite of the removal of tax relief on purchased goodwill – see above) and the s 165 route to incorporation would therefore resent a much higher tax charge. However, there are many businesses where a third party sale is unlikely, and therefore the additional tax is unlikely to arise.

Small Company Tax Review (Lecture B954 – 13.22 minutes)

The Office of Tax Simplification (OTS) has published its 'Small company taxation review'. It focuses on making the tax system simpler for micro-companies with fewer than ten employees.

Overview

The report makes a number of suggestions, some of which would see a major shake-up of small company taxation if they are taken up by HMRC, including.

- A 'look through' approach with shareholders being taxed directly on the company's profits instead of the company paying corporation tax: to offer simplification for one-person businesses which distribute most or all of their profits and are not looking to increase in size.
- Cash accounting for companies similar to cash accounting for unincorporated businesses.
- A 'sole enterprise protected assets' structure to give sole traders liability protection for their personal assets without the need to incorporate.
- Consideration as to how a consolidated tax model for micro companies could be established in the UK.

Introduction

This review presents recommendations to the Chancellor of the Exchequer and Financial Secretary to the Treasury on how to simplify the tax system for small companies, increase certainty and reduce administrative burdens

This review is largely focussed on the smallest companies - those with fewer than ten employees, often referred to as micro- companies. However, we have had regard to all companies with less than 50 employees when conducting this review

Understanding the small company landscape

To be able to consider how to simplify the tax system for small companies, one must first understand small companies, including the reasons why they are formed, their structures and the plans and goals of their owners.

Small companies are owned and run by individuals who are generally skilled in their sectors and aim to offer services and/or goods. The small company owners and representatives we met consistently made clear that the primary concern of small company owners is the successful running of their business interests,withtaxasecondaryconcern.

We have identified at least four distinct types of small companies:

- Non-employing companies or single entity companies - Companies formed of one individual that operate in the same way as a sole trader but have the legal form of an incorporated business. Most or all of the profits are extracted from the company with very little retained for investment in anything other than stock. These companies typically dissolve once the trader retires.
- Personal Service Companies - The director is also the sole or main shareholder. They conduct their work under contracts that could otherwise see the director treated as an employee of their customer. However, operation is through a company, often as an attempt to bypass employment law on their customers' insistence.
- Non-growth companies - These companies may represent the typical small company with tangible assets, property and possibly a few employees. However, there is no intention to grow significantly. As with sole trader companies, most or all of the profits are extracted from the company with very little retained for investment in anything other than stock. Many of these companies dissolve once the owner or owners retire.
- Growth companies - These companies fit the archetypical view of small companies: growing from incubation into medium and larger companies. For these companies, the small company phase is merely a transition. A relatively new phenomenon within this space are rapid growth companies - creative and technological start-ups, and trading companies that make use of the internet and modern logistics to rapidly access a very large marketplace.

The UK tax system has not been specifically designed to accommodate modern small company forms.

Incorporating creates a significant problem for many micro businesses, especially nanos. Many proprietors simply do not understand the accounting and tax requirements of a company but are comfortable with the requirements of an unincorporated business.

The tax system also puts disproportionate administrative burdens on smaller companies.

Simplification on this front also has a key benefit to HMRC. By simplifying the reporting requirements, HMRC can simplify the monitoring and enforcement arrangements for most small companies and better target resource at those who are deliberately abusing the system.

In our Employment Status report, the OTS considered the idea of a Freelancer Limited Company (FLC). At the time its proponents were putting this forward as an alternative vehicle but we were unconvinced with the idea and in effect challenged them to develop the concept to meet our concerns. We have discussed the idea further and the revised version of the FLC is now essentially:

- A standard limited company;
- With restrictions on its arrangements and activities;
- With the aim of a FLC offering insulation from IR35.

We think this developed FLC concept is worth considering further.

Accounts, taxable profit and cash

For many small companies there are three sets of figures they have to prepare or maintain:

- Accounts proper, for eventual publication;
- Tax records and computations, to lead to corporation tax figures;
- Cash records.

Real simplification could be achieved if these three converge, ideally into one set.

Accounting requirements: can accounts and cash converge?

Small companies and accountants told us that, for many, it's not just the tax treatment that is complicated but the requirement to file accounts according to generally accepted accounting principles (GAAP).

It is important to consider accounting requirements when considering tax simplification for small companies. An efficient way to simplify the tax and accounting system for small companies would be to use a sole trader tax treatment while simultaneously providing for cash accounting

The potential benefits of such an arrangement are significant:

- An accounting treatment that many small company owners are able to understand as it is similar to how many run their day-to-day financial affairs;
- A system that will enable much simpler regular reporting for tax purposes, so likely to facilitate quarterly reporting as proposed under Making Tax Digital (MTD);
- Potentially significant cost savings for small companies through a reduction in accountancy fees;
- Continued benefits of limited liability and a separate legal entity for business operations.

We recommend that the possibility and practicality of a cash basis of accounting being used for the smallest companies is explored. This recommendation would require an exemption from the EU Accounting Directive, which currently requires all company structures with limited liability to file accruals accounts.

Aligning taxable profit with accounting profit

Another approach to simplification would be to align taxable profit more closely with accounting profits. The move to more frequent reporting (or engagement with HMRC) under Making Tax Digital (MTD), and the need to make this obligation as light touch as possible, brings this into sharper focus. In the OTS's UK Tax Competitiveness Report we recommended exploring:

- Whether many of the 'sundry tax adjustments' could be eliminated;
- A general move to taxing the accounting profits with minimal adjustments;
- Tax businesses on business profits rather than streaming between trade and investment;
- Replacing capital allowances with a deduction for depreciation, subject to considering provisions on how to best protect those wishing to claim the annual investment allowance;
- Minimising the need to maintain additional accounting systems for corporation tax.

If harmonising accounting profit and taxable profit is difficult or impractical, what of aligning a cash profit with taxable profit?

This route clearly fits well with the MTD ideas. To allow the company to make any quarterly return or payment simply on the basis of cash would be simpler.

A look-through basis

A number of countries operate a 'transparent' tax. This is where small company profits are taxed directly on the shareholders, with the company itself paying no form of corporation tax. We have considered a specific form of transparent tax called look-through. This would mean the shareholders being assessed to income tax and national insurance contributions (NICs) on their share of the profits. Dividend distributions would not be subject to tax as the profit share would alreadyhavebeencharged.

One area where virtually all respondents were in agreement was that if any look-through scheme was introduced, it should not be compulsory, though that raises concerns with the OTS about adding complexity through choice (and of course the implication that it could become a 'lower tax' choice.

The main argument against look-through was that it would subject profits retained by the company to full income tax/NICs and therefore reduce the funds available for investment and growth. For this reason, a look-through based system would not be suitable for growing companies. However, for the large proportion of small companies that do not grow, and have no intention of growing, a look-through system could work.

The OTS believes there is sufficient merit in a look-through basis for a target range of companies to warrant developing an outline of such a system in sufficient detail to generate proper debate. We recommend that the OTS undertakes this task.

The basis would be a look-through system for a target range of companies that:

- Do not intend to increase in size;
- Are effectively one-person businesses;
- Distribute all (or almost all) their profits; and
- Have few assets or need for investment funds.

Specificissuestoaddressinclude:

- Defining and managing the target range of companies;
- Whether this would be a compulsory, default with opt-out or optional system;
- Transitional considerations, including the whole impact of the potential change in system of taxation for the target companies.

Consolidated tax model

The OTS report considers alternative business structures and methods of taxing businesses in detail, looking at consolidated tax regimes in a number of countries.

A further recommendation in the report is the study of a "consolidated tax model as part of a longer term strategy for genuine tax simplification for micro companies".

Such a system could include the following attributes:

- Turnover as a basis for tax.
- A cash basis so tax is payable on receipts.
- Different tax rates or fixed deductions to take account of different businesses.
- A consolidated tax to replace corporation tax, PAYE and NIC, as well as personal income tax on distributed profits and possibly business rates.
- A turnover threshold for eligibility, possibly aligned with the VAT threshold.

Recommendations

The OTS makes a number of recommendations:

- Aligning taxable profit with accounting profit by eliminating sundry tax adjustments.
- Aligning filing and payment dates across government departments; VAT, PAYE, Corporation Tax, Annual Returns and Statutory accounts.
- Improve the VAT MOSS system that deals with EU cross border VAT issues.
- Raising awareness of the VAT flat-rate scheme and considering the feasibility of an advance-clearance facility for VAT.
- Revisiting disincorporation relief, increasing the £100,000 limit and extending the relief to transfers to a limited company.
- Provision of out of office hours support by HMRC given that small company owners are often running their companies during working hours and dealing with tax and administration during evenings and weekends.
- A more streamlined on-stop-shop approach to enable businesses and their agents to discuss multiple taxes in a single phone call, and also linking Companies House with HMRC to avoid double entry and reporting of information.
- Introducing a unique identifier code across all taxes and by Companies House.
- Making HMRC's i-forms more flexible for users, including enabling users to view different pages without first having to complete each one fully.

This report was prepared following an announcement in the Summer 2015 Budget, and a survey to collect views from small companies ran until 1 January 2016.

HMRC responded to the OTS by letter in April 2016 accepting most of the proposals but rejecting the consolidated tax model using turnover as a basis for tax.

Losses denied - Was the taxpayer carrying on a single trade?

Summary- The First-tier Tribunal found that a taxpayer who provided consultancy services and leased an item of machinery was not carrying on a single trade.

The taxpayer provided consultancy services to sectors including transport, oil, gas, construction and education. He also leased an item of machinery for use in the oil extraction industry and claimed capital allowances on it. He claimed to carry forward losses under s83 ITA 2007 against his profits because the allowances exceeded the income.

HMRC refused the loss claim, on the ground the taxpayer was carrying on two trades and, under s 83(3), the losses could be carried forward against profits of the same trade only.

Decision:

The First-tier Tribunal said the provision of machinery under a lease was 'conceptually' different from that provision of consultancy services. A high degree of linkage would be required for them to be regarded as a single trade. In this case, the taxpayer could not provide that.

As a result, the tribunal concluded the taxpayer had two businesses and the losses against the leasing of machinery could not be off set against the consultancy.

However, the tribunal considered that there was a 'genuine difference of opinion' on this point between HMRC and the taxpayer.

It did not agree with HMRC that the taxpayer deliberately calculated his tax incorrectly and the Revenue was not entitled to impose a penalty on that basis — it had not shown that the taxpayer's behaviour had been careless or deliberate.

However, this was a preliminary decision with other matters to be decided later.

Comments – The issue of whether the taxpayer was carrying on one or two trades was considered as a question of fact based on the High Court case of Scales (HMIT) v George Thompson & Company Ltd in 1927.

A Adelekun v HMRC TC4898

Availability of post cessation relief

Summary - The FTT found that neither interest relief nor post-cessation relief were available.

Mr Saheid and his wife ran a post office, a farm and a care home. He appealed against a closure notice denying the deductibility of loan interest and legal and professional fees relating to the post office business. HMRC contended that Mr Saheid had not shown that the relevant loans had been taken out for business purposes and that the legal and professional fees had been incurred after the trade had ceased.

Mr Saheid was not able to show that the loan proceeds, in relation to which he had claimed interest, were paid into the post office's account. He conversely was not able to demonstrate that loan and credit card interest payments had been made from an account used for the post office business. He accepted that income from the other businesses was used to fund this account.

Decision:

The FTT upheld HMRC's decision not to allow the interest deductions being sought.

The FTT found that that Mr Saheid's objective in pursuing legal action was to obtain compensation for the way in which the termination of his contract had been handled by the post office. The FTT therefore noted that, to the extent that Mr Saheid hoped that a new contract would be given, this was a situation where the trade had already ceased, rather than one where the trade was continuing pending the resolution of a legal dispute. Since none of the legal fees had been incurred before the trade had ceased, the issue was whether they qualified for post-trade cessation relief.

The FTT, having stressed the lack of evidence put forward by Mr Saheid, found that the conditions for the relief had not been met. Mr Saheid's case was that the payments were made 'wholly and exclusively ... in defraying the expenses of legal or other professional services in connection with any claim that work done, goods supplied or services rendered in the course of the former trade, profession or vocation was or were defective'. However, the Post Office was not suing for defective services but simply ending the contract as a result of complaints made by customers. There was no claim falling within ICTA 1988 s 109.

Finally, the FTT struck out Mr Saheid's appeal in relation to earlier years, as there was no appealable decision.

Comments - The FTT examined the deductibility of loan interest claimed by Mr Saheid against the post office profits but found that the loans had not been used for the purposes of the post office business and the interest was not deductible. The FTT also considered a claim for post-cessation trade relief in respect of legal expenses incurred in litigation between Mr Saheid and the Post Office but found that not only had a claim not been made within the relevant time limits, but the legal action was not defending defective service and so did not fall within s109A ICTA 1988 (now s97(3) ITA 2007).

M Saheid v HMRC TC 4982

VAT

Input tax on property disallowed because of vague intention

Summary – The First-tier Tribunal dismissed the appeal against HMRC's decision to deny credit for input tax relating to the purchase of a property.

In February 2012, the taxpayer, a father and son partnership, bought a property with the intention of trading as a butcher's shop, a taxable activity. A month later, the partners notified their intention to change the activity to a day nursery for children, an exempt business.

The partnership submitted VAT repayment returns claiming input tax without declaring output tax. HMRC disallowed all input tax claims on the basis there was no link to taxable supplies. The taxpayer appealed.

Decision:

The First-tier Tribunal concluded that 'on the balance of probabilities' it was likely that taxpayer had intended to trade as a nursery as soon as the property was purchased, so there was never an entitlement to claim input tax. The tribunal said the taxpayer had not 'seriously pursued' the meat business and had used it 'to support a claim to deduct VAT on the purchase of the property'.

The judge was not impressed with the senior partner as a witness, accusing him of 'exhibiting braggadocio'. He also failed to give 'a straight answer' to questions.

The taxpayer's appeal was dismissed.

Comments – The outcome of this type of case is critically dependent upon the facts. The appellant was not professionally represented at the FTT hearing, which probably restricted the chances of persuading the FTT that the asserted intention to open a shop was genuine

S Gulzar and S Gulzar (trading as Lions Cub Nursery) v HMRC TC4653

Group structure not artificial

Summary - The FTT found that a group structure which involved two companies in the same business was not artificial. The FTT held that the majority of the inter-company supplies made were supplied at open market value but set out the method to be adopted to value the remainder.

Two associated companies (TF and TR) carried out the 'PerfectHome' business. The business involved the sale of household goods furniture and electronic goods to consumers. It was aimed at credit constrained customers and most of the goods were sold under hire-purchase contracts, together with (optional) insurance and warranty.

TF provided finance and other services to customers, whilst TR sourced and supplied the goods. HMRC contended that the arrangements were artificial and that only one business was being carried out.

Decision:

The FTT was, however, satisfied that the 'two company' structure had not been set up with a view to securing VAT advantages, but had clear commercial advantages.

Sch 6 VATA 1994 applies only in relation to goods or services provided for a consideration that is less than their open market value. HMRC contended that TR, as a wholesaler, charged TF more than the open market value (97% of the retail price) for certain goods or services; and that this, in turn, suggested that TR 'compensated' for this element of overcharging by undercharging for other services.

The FTT found, however, that TR was not a wholesaler, given its expense of maintaining a large number of retail showrooms. Furthermore, while it sold large quantities of goods to TF in aggregate, it only sold a particular item to TF if TF was about to sell that item to an individual customer. It did not sell large quantities of goods in a single transaction.

Finally, the FTT found that TF's business involved the making of taxable supplies of goods. Moreover, it could not make exempt supplies of finance without making those taxable supplies (since it did not provide finance other than for the purpose of enabling a customer to purchase goods). The taxable and exempt supplies were therefore inextricably linked with each other and the amount of its recoverable input tax on overheads should be determined by applying the standard (turnover-based) partial exemption method.

Comments - This case is a reminder that HMRC will use their powers under Sch 6 VATA 1994 to direct and assess supplies between connected parties at Open Market Value (if the person receiving the supply is not entitled to deduct all the input tax); and also the Standard Method Override to counter situations where they consider that a disproportionate amount of input tax is being recovered. Connected businesses with inter-company supplies where the recipient of the supply is unable to fully recover input tax should ensure that the values used can be substantiated if challenged by HMRC.

Temple Finance and Temple Retail v HMRC TC4840

Single or multiple supply?

Summary - The First-tier Tribunal dismissed the appeal against HMRC's decision that there was a single charge for one standard-rated supply, which encompassed the right to fish and the chance of catching and keeping them.

Stocks Fly Fishery ran a fishing reservoir. It sold tickets for daily fishing and the tariff depended on how many fish (if any) the holder was allowed to keep. Having accounted for VAT on all income received, it had made a claim for repayment covering a period of four years on the basis that it actually made two supplies: one of fishing (standard-rated); and one of fish for human consumption (zero-rated).

Decision:

Referring to *Card Protection Plan* (C-349/96), the FTT emphasised that the essential feature of the supply, in all types of tickets, was fishing; and that the primary objective of anglers going to the fishery was to fish. The FTT observed that, looked at 'objectively', there was no difference between the motivation of those who went to fish entirely for sport, and those who went to fish intending to take away any fish they caught.

The FTT added that the experience of the reservoir was wholly different from buying fish at the fishmongers. Furthermore, customers were not guaranteed to catch any fish at the time of the ticket purchase. It therefore could not be contended that the price of the ticket included consideration for the supply of fish.

Comments - This case is similar to Chalk Springs Fisheries in 1987, where the taxpayer unsuccessfully argued that there were two supplies: the right to come onto the land to take fish (standard-rated); and the trout caught (zero-rated). Unlike the present appeal, there were no sporting tickets: all fish caught had to be killed. The tribunal dismissed the taxpayer's appeal and held that there was a single supply, because 'what the intending fisherman receives for his money is simply the right to go onto the land to catch trout, limited in duration and in number. No trout is, in my view, supplied to him at all. Instead the fisherman must go out and catch them, if he can.'

Stocks Fly Fishery v HMRC TC 4994

Legality of 'fish and chips tax'

Summary - The FTT dismissed four appeals against HMRC's decision not to repay output tax on supplies of hot takeaway food.

It was accepted by all four appellants that their original grounds of appeal, stated in their notices of appeal, had raised the same legal issues as had been decided by the Court of Appeal in *Sub One i*n the Court of Appeal in 2014 in favour of HMRC. However, they raised new grounds of appeal, which had not been decided in the *Sub One* litigation.

Decision:

The FTT accepted that the appellants' delay in identifying the new grounds may have prejudiced HMRC, as the appeals may take longer to resolve. However, this did not justify keeping out an arguable point of law. The issue was therefore whether the new grounds had any reasonable prospect of success.

These new grounds were that the Second Council Directive art 17 had continued to be part of EU law when the Principal VAT Directive (PVD) had come into effect; and that art 17 (via art 16) made it compulsory for a member state to refer to the Commission for the purpose of consultation before introducing an exemption with refund. The UK had, however, failed to consult when in 1984 hot takeaway food had ceased to be zero-rated (the so called 'fish and chips tax').

The FTT found however that the PVD art 28 had only incorporated the 'last indent of art 17' and not the consultation condition. Furthermore, on a purposive interpretation, consultation would have been required in 1967 when art 17 had been concerned with the introduction of exemption and zero-rates, whereas the PVD art 28 had simply been concerned with maintaining these zero and reduced rates, which already existed. In any event, art 17 had been concerned solely with the introduction of zero and reduced rates in a new harmonised VAT system; and therefore the consultation precondition had not been intended to apply to the later reduction in such rates some time after they were introduced.

Comments - The FTT rejected all of HMRC's arguments against the admission of new grounds of appeal, noting in particular that the absence of a good reason for the delay was not sufficient in itself to keep out an arguable ground, particularly if the delay had not been deliberate. However, it found that the appeal had no reasonable prospect of success.

Koon Chung and Yuk Fong Lam and others v HMRC TC 4991

Was a mental health unit a 'hospital or similar institution'?

Summary - The First-tier Tribunal (FTT) allowed the appeal against HMRC's decision that zero-rating did not apply to the 'goods and services' supplied in the course of constructing a mental health residential unit.

The issue was whether the construction services and materials received by Pennine Care in the course of the construction of a mental health residential unit were zero-rated, as supplies in the course of the construction of a building intended for use solely for a residential purpose. This would not be the case if the unit was intended for use as 'a hospital or similar institution'.

Decision:

Following *General Healthcare Group* (VATD 17129), the FTT noted that a number of factors could determine whether the unit was a hospital; and that all definitions of 'hospital' referred to medical treatment and care (*Fenwood Developments* [2006] STC 644). The main area of contention was whether the care provided at the unit affected the residents' illnesses through treatment, rehabilitation and mental health nursing.

The FTT found that the assessments, reviews and therapies undertaken by the staff were distinct from diagnosis. Whilst residents were treated, in that their medication could be altered or changed, this was ancillary to the care provided. The unit could only help residents learn to manage the manifestation of symptoms of their illnesses; it could not prevent the deterioration of the illness itself.

The FTT concluded that 'personal care' was a term that reflected current times. In the context of mental health illness, the inclusion of the type of bespoke and specialist care provided by the unit did not make it a 'hospital or similar institution'.

Comments - This case illustrates some of the complex provisions that apply to zero-rating for certain construction supplies.

Pennine Care NHS Trust v HMRC TC 4998

The DIY scheme and the retention of a gable wall

Summary - The First-tier Tribunal dismissed Andrew Reeves appeal against HMRC's rejection of his claim for repayment of VAT under the DIY Housebuilders' Scheme finding that the works he carried out were the reconstruction and enlargement or extension of an existing building falling within the exclusion provided by Sch 8 Group 5 VATA 1994 Note 16.

Andrew David Reeves submitted a claim for repayment of VAT pursuant to the DIY Housebuilders Scheme in relation to work done on premises known as 'Woodcroft'. HMRC refused the claim on the grounds that the work was not considered to be a 'new build' because although the existing bungalow had been almost entirely demolished and rebuilt, a gable wall and interior wall had been retained which meant the works had to be treated as alterations to an existing building. Mr Reeves appealed to the Tribunal.

Decision:

The FTT noted that s35 VATA 1994, s. 35 made provision for a refund of VAT incurred by persons constructing a building designed as a dwelling, known as the DIY Housebuilders' Scheme and that broadly, the scheme precluded refunds for conversions, reconstructions or alterations of existing buildings unless the existing building was demolished to ground level or save for a single facade that planning or similar permission required to be retained.

The FTT further noted that HMRC had refused the claim because (1) there was no planning condition or other agreement to retain the gable wall and (2) the gable wall was not a facade; a facade being more than a wall that has remained standing but a street facing frontage that has character or significance to the area that would lead to its retention.

The FTT disagreed with HMRC that there was no planning condition or other agreement with the planning authority requiring retention of the gable wall. The original planning consent included retention of three walls, including the gable wall and the subsequent agreement with the planning authority was that they would not require a new planning consent to permit demolition of the other two walls; that later agreement, however, did not affect the gable wall at all. The matter, therefore, turned on whether the gable wall was a facade. The FTT noted that if it was, then the original Woodcroft building ceased to exist and Note 16 could not exclude Mr Reeves' claim. If the gable wall was not a facade, however, then the original Woodcroft did not cease to exist and the works plainly amounted to reconstruction, alteration, and enlargement of, and/or an extension to the existing building.

The FTT noted that the ordinary meaning of facade per the Oxford English Dictionary was the face or front of a building and not simply a wall. The gable wall was clearly not the front of the building as it did not face forwards towards the lane which meant it was not necessary to decide whether a facade had to have some architectural character or significance or whether a gable wall with architectural character or significance might be a facade.

The FTT concluded that Woodcroft did not cease to be an existing building and the works undertaken were the reconstruction together with the enlargement or extension of that existing building; they fell within Note 16 and did not amount to the construction of a building for the purposes of s35 VATA 1994.

The appeal was dismissed.

Comments - Andrew David Reeves bought a two bedroom bungalow with the intention of altering it to provide a four or five bedroom home. The original plans included retention of three existing walls but following architect's advice during the course of construction, only one wall was retained. Mr Reeves submitted a claim for repayment of input tax under the DIY housebuilders scheme which HMRC rejected on the basis that the works did not constitute a 'new build'. The FTT has rejected Mr Reeves appeal finding that as the works were the reconstruction and enlargement of an existing building they were not eligible for the relief.

Reeves v HMRC TC4980

Deductibility of input tax on SFPE Units

Summary - The Upper Tribunal dismissed HMRC's appeal against the decision of the First-tier Tribunal that the purchase of the SFPE units did not represent an investment, i.e. there was a business activity so certain input tax was recoverable.

The Appellant company ran a farm. Under the Common Agricultural Policy, the Appellant was entitled to benefits under the Single Farm Payment (SFP) Scheme. Initially, it received 194.98 units of Single Farm Payment Entitlements (SFPEs). Units of SFPEs may be traded. In addition to its initial allocation, the Appellant purchased units at a cost in excess of £7m, excluding VAT of £1,054,852. To secure payment of the SFPEs, the Appellant must have 'at its disposal' on 15 May of the relevant year one hectare of agricultural land. For each unit and for this purpose, it entered into seasonal grazing leases. In conjunction with each lease, it also entered into a post-lease agreement with the landlord, which enabled the latter to continue farming the land. Provided that the land was maintained in Good Agricultural and Environmental Condition (GAEC), which the post-lease agreement stipulated, the Appellant was considered to hold the land 'at its disposal' for purposes of payment of the SFPEs. The Appellant purchased the units in order to use the income arising in settling its overdraft and both developing and diversifying its farming business.

HMRC refused credit for the £1,054,852, on the basis that the purchases of SFPEs represented an investment, i.e. a non-business activity. VAT on the purchase of the entitlements was allegedly irrecoverable as it did not relate to the making of a taxable supply.

The FTT held that the acquisition of SFPE units was a funding exercise, which related to business overheads.

Neither party argued that there is any material difference between EU and UK law. Primarily, HMRC argued that the SFPE units had been acquired for the purpose of obtaining SFPs, i.e. for the purpose of a non-economic activity outside the scope of VAT. In such circumstances, no right of deduction arose.

Alternatively, HMRC argued that the FTT had erred in law in holding that there was a direct and immediate link between the cost of acquiring the SFPE units and the company's taxable economic activity, so as to entitle it to reclaim the VAT.

There were two ways in which the 'direct and immediate link' test could be satisfied:

1. if there was such a link between the services acquired and a particular output transaction; or
2. where the services had a direct and immediate link with a clearly defined part of the taxable person's economic activities consisting of the making of taxable supplies, so that the costs formed part of the overheads of that part of the business. In the present case the company claimed to satisfy the test in the second of those ways, but no such link had been established. A causal link between cost incurred on a supply and a taxable person's overall economic activity was insufficient.

Decision:

The UT agreed with the FTT, on the basis of its primary findings of fact, that the financing opportunity afforded by purchasing the SFPE units did not form a distinct business activity, but was a 'wholly integrated feature of the farming enterprise', rather than a separate enterprise. There was ample evidence to entitle the FTT to make that finding. The UT rejected HMRC's submission that the FTT had erred in placing weight on evidence of the intention of Mr Smart, as the company's controlling mind. A fundamental feature of the VAT system is that the right to deduct arises immediately on the incurring of the tax, and may be exercised in respect of goods and services intended to be used in connection with taxable transactions.

The UT considered whether, on the FTT's findings, there was the necessary direct and immediate link between the cost of the SFPE units and the company's taxable business supplies. The input tax was not incurred in connection with a particular output transaction, so the starting point was whether the cost, in respect of which the input tax was charged, was incurred for the purposes of its economic activity in general. If so, it must be considered to be part of the company's overheads.

Thus, it is a cost component of the price of the company's products. The necessary direct and immediate link is thereby established. It is unnecessary for the company to prove that the cost in question was built into the price charged for the supply.

The UT held that, once the cost was found to be for the benefit of the company's taxable activity, as the FTT had found, it must be treated as a cost component of the business's taxable supplies. Thus, HMRC's appeal failed.

Comments - It might be thought that HMRC's decision to disallow the VAT charged on the SFPEs was due to the Appellant holding so many SFPEs. However, during the hearing, HMRC confirmed that their position was that any purchase of SFPE units, regardless of how closely or otherwise it related to the carrying on of a farming business, fell foul of their primary argument based on use for non-economic activity**.**

RCC v Frank A Smart & Sons Ltd [2016] UKUT 0121 (TCC)

Output tax due on overpaid car parking fees

Summary - The First-tier Tribunal (FTT) dismissed the appeal against HMRC's decision that payments, which exceeded the car parking tariff, constituted consideration for a standard-rated supply of services.

The issue concerned whether voluntary payments in excess of car parking charges were consideration for a supply of services and subject to VAT. HMRC said they were and refused the taxpayer's VAT repayment claim. The situation arose when a customer did not have the correct change for, say, an hour's parking and therefore overpaid because the payment machine did not give change.

A similar situation arose in *King's Lynn and West Norfolk Council* (TC671). The tribunal in that case decided in favour of the council because it was restricted in the amount it could charge for parking because of a statutory order. The instant case concerned car parks run by NCP Ltd, which is a commercial business and is not restricted on how much it can charge. However, despite the tribunal accepting that a customer would be unaware of that difference, it was not inclined to apply the *King's Lynn* decision in this case. First-tier Tribunal decisions were not binding and the tribunal in that case had not heard the 'detailed arguments' put forward this time.

Decision:

The tribunal judge concluded that the relevant time for NCP to account for VAT was when customers pressed the green button on the ticket machine to confirm they accepted the parking charge. The judge said the full payment — including any additional amount — made by the customer was relevant for output tax and dismissed the taxpayer's appeal.

Comments - The FTT examined the Statutory Order, which was referred to in Borough of King's Lynn and West Norfolk, and had doubts whether it stopped that Borough from charging more than the stipulated amount, given that it merely set out the charging bands for the time periods. However, the FTT noted that a significant aspect of the FTT's reasoning was that the Borough could not, as a matter of law, offer customers parking services for any amount other the tariff amount. That was not true for NCP

National Car Parks Ltd v HMRC TC4784

The distance selling rules (Lecture B955 – 12.03 minutes)

<u>Background</u>

Here is an opening teaser: what is the difference between a UK business selling £40,000 of goods each year to customers based in Denmark who are not VAT registered (usually private individuals) compared to a business that sells the same goods to customers in Germany who are also not VAT registered? The answer is that the business will charge Danish VAT on the sales to customers in Denmark but UK VAT to those based in Germany. Why is this? Read on and all will be revealed.

Distance selling thresholds

The aim of EU VAT law is to create a level playing field between all Member States, so that a business has no competitive advantage being based in, say, Luxembourg which has a low VAT rate of 17%, compared to one based in, say, Sweden where the domestic rate is 25%. And an important tool to assist that aim is the distance selling rules, which can be summarised as follows:

If an EU based business sells goods to customers in another EU country where the customer is VAT registered, the sale will be zero-rated. The customer will account for acquisition tax on his own VAT return based on the domestic rate of VAT that applies to the goods in question. The supplier must retain proof that the goods have left his country ie as a condition of zero-rating and he will also record the customer's VAT number on his sales invoice(s) and a note instructing the customer to account for tax on his own return. See Example 1.

Example 1 – accounting for acquisition tax

If a VAT registered UK business buys £1,000 of screws from a business in France, it will account for acquisition tax of £200 in Box 2 on its next VAT return, and claim the same amount as input tax in Box 4, assuming the screws are used for taxable purposes eg purchased for resale. The net value of the purchase ie £1,000 will be recorded in both Box 7 and Box 9. If the business uses the screws for exempt or non-business purposes, there will be an input tax restriction in Box 4.

Note – don't forget that Boxes 8 and 9 of the VAT return are only relevant to goods and are always silent in relation to sales and purchases of services.

If an EU based business sells goods to unregistered customers in another EU country, then domestic VAT is charged on the sale in exactly the same way as if the customer was based in the supplier's own country. However, the business must keep a record of total sales it makes to unregistered customers in each EU country on a calendar year basis.

If total sales into a country (only to customers without a VAT number) exceed the distance selling threshold that applies in that country, the supplier will cease to charge domestic VAT (which could happen part way through a calendar month) and get a VAT number in the customer's country. Future sales will then charge VAT according to the rate that applies in the customer's country for the goods in question, which will be declared on VAT returns submitted to the overseas tax authority with the new registration.

A Member State can choose one of two thresholds for sales made into its country, either 35,000 Euros or 100,000 Euros. The UK is outside of the Euro zone, so the relevant figure for EU businesses making sales to unregistered UK customers is £70,000 (VATA1994, Sch 2, para 1).

Note – as a general principle, the countries with the higher rates of domestic VAT eg Denmark, Ireland and Sweden have opted for the lower threshold but countries with lower rates eg France, Luxembourg and Germany have opted for the higher thresholds. But an accurate list can be obtained on the ec.europa.eu website. My references here to Denmark and Germany also answers my opening teaser.

Points to note:

The turnover tests are only carried out on a calendar year basis. So if you sold 99,999 Euros of goods to unregistered customers in France in the 12-month period to 31 December 2015, then you have averted the need to get a French VAT number and therefore start with a zero figure again on 1 January 2016.

It is important to be aware that sales to business customers are included in the calculations if the customer does not have a VAT registration in his own country eg because he is trading below the domestic registration threshold. Sales to many charities or public bodies would also be included if they are not VAT registered.

What if the limits are ignored?

My personal view is that many UK business owners (and some advisers) are unaware about the distance selling thresholds – or are aware of them but have forgotten to take them into account and review the level of relevant sales made to each EU country. I know of one situation where the German tax authorities identified that a UK business had been trading over the threshold in Germany for many years, and had taken action to collect arrears. I had a similar situation to deal with a number of years ago involving a UK business selling golf club buggies into Ireland.

So what happens if a UK business has been charging UK VAT on its sales for many years into Germany, when it should have obtained a German VAT number and charged German VAT under the distance selling rules? See Example 2.

Example 2 – late registration under distance selling rules

Sports Ltd is based in the UK and sells footballs to football clubs in Germany that are not registered for VAT. It should have registered for VAT in Germany on 10 June 2013 under the distance selling rules but failed to do and has been incorrectly charging UK VAT on sales since that date.

In this situation, a credit for UK output tax will be needed in relation to sales since 10 June 2013 and German VAT will instead be payable on these sales - fortunately this gives a good outcome because the VAT rate in Germany is 19% ie lower than the UK. If the error had been made in relation to eg Denmark where the VAT rate is 25%, then the UK business would be out of pocket with the VAT adjustment.

Accounting and VAT return issues

This is where things get a bit tricky - let us remain with the German football scenario in Example 2:

The UK business buys the balls from a UK supplier and is charged UK VAT. It will claim input tax on its UK VAT return in the normal way.

The balls are stored at premises in London and then shipped directly to the German football clubs, with German VAT charged on the sales because of the distance selling rules.

If a UK business transfers goods to another EU country, and stores goods at eg a warehouse it owns or rents in that country, and makes sales to customers in that country from the warehouse, then it will usually need a VAT number in the second country. In such cases, the business is classed as making a supply of goods from its UK branch to its overseas branch at the time of the stock transfer ie with acquisition tax accounted for by the overseas registration (see HMRC Notice 725, section 9).

However, in the case of distance sales ie where the goods go directly from the UK premises to the customer, there is no acquisition tax payable through the overseas registration – and the following entries are relevant on the UK and German VAT returns:

UK VAT return - Box 6 and Box 8 entries are made to record the sale – no Box 1 entry is needed because output tax will be declared on the German VAT return. An Intrastat declaration will be made (if the business is registered) as a dispatch.

German VAT return - output tax will be declared because German VAT has been charged and the net value of the sales will be recorded in the Box 6 equivalent of the return (ie outputs box). An Intrastat entry as an arrival will be made if the business is registered for Intrastat.

There is no issue with EC Sales Lists which do not need to be completed.

HMRC Notice 725 – para 6.17.

Final tips

Here are a couple of final issues to consider on this very important subject, which has become even more relevant in the modern trading world because of online sales of goods on the Internet:

Be aware that there is no distance selling threshold for goods that are subject to excise duty. These goods are always taxed in the country of destination. This means that an EU supplier who arranges the delivery of excise goods to a non-VAT registered customer in the UK must register for VAT here and vice versa (HMRC Notice 725, para 6.7).

A business might decide to register under the distance selling rules before it has exceeded the 35,000 or 100,000 Euros limits. There is no problem with this approach (ie a voluntary registration) and it might be sensible for a UK business to go down this route if the customer's country has a lower VAT rate than the UK or, perhaps, applies lower VAT rates (reduced rate rather than standard rate) to the goods in question. See HMRC Notice 725, para 6.10 to 6.13.

Contributed by Neil Warren