Tolley®CPD

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Contents

Personal Tax 4

Conditions for a company director to qualify for EIS relief 4
Travel expenses for a temporary workplace 5
Treatment of PILON 5
Relief for accommodation allowances 6
Charity involved in tax avoidance 7
Setting off the personal allowance (Lecture P956 – 10.28 minutes) 8

Capital Taxes 11

Ordinary share capital and shares with no entitlement to dividends 11
Share loss relief claim 12
QCBs and redemption in a currency other than sterling 13
Allowable expenditure and goodwill 14
Disclosure of medical records to determine inheritance tax liability 15
Interaction between EIS relief and taper relief 16
CGT avoidance scheme 17
Exploiting the limitations of S67 IHTA 1984 (Lecture P960 – 20.18 minutes) 18

Administration 20

Bad advice - Interest due as a result of official error 20
Appeal to continue – FTT Jurisdiction to close a COP9 enquiry 21
Underpaid PAYE tax as a result of applying incorrect code 22
The effect of the HRA 1998 on UK tax 22
Application for closure notice and ill-health 24
Dispute continues – so referral to the Tax Disputes Resolution Board 25
Jurisdiction to make cost orders 26
Gift Aid Small Donations Scheme - Consultation document (Lecture P 958 – 6.50 minutes) 27
Part surrenders and part assignments of life insurance policies - Condoc 29
Tax deductibility of corporate interest– consultation 33

Deadline Dates 37

HMRC News 39

230,000 benefit as pension revolution marks one year milestone 39
An insight into key developments with HMRC (Lecture B959 – 17.00 minutes) 40

Business Taxation **43**

Capital or revenue (Lecture B956 – 15.15 minutes) 43
Loans to participators (Lecture B957 – 11.27 minutes) 51
Was a debit allowable under the loan relationship rules? 52
Did income from diving activities represent business profits? 54
Treatment of a trading loss incurred by a partnership 55
Were parking fines deductible? 56
Peer-to-peer loans (Lecture P957 – 10.43 minutes) 56
Failure to make construction industry scheme deductions 58
Intra-group swap transfer and closure notice 59
Finance costs related to residential property businesses (Lecture B958 – 12.05 minutes) 60
Extended averaging for farmers (Lecture B959 – 17.05 minutes) 62
Claim to set farming losses against other income 65

VAT **66**

Recovery of input tax incurred on production of a report 66
Application for judicial review of decision to change VAT calculation method 67
Too vague an estimate - Rules for exception from VAT registration 68
Retrospective entry to the flat rate scheme 69
Were timber structures caravans? 70
Partial exemption methods and groups 70
Road fuel scale charge for cars used by sale reps 71
Did gym membership payment include an exempt supply of credit? 72
HMRC's use of best judgment 73
Is a game with or without interaction with other players? 73
Amendment of existing claim or new claim? 74
Philanthropic exemption 75
Option to tax validly exercised 76
VAT treatment of converted public house 77
“Halifax” applied to a scheme for the recovery of input tax 78
VAT Payback and clawback adjustments (Lecture B960 – 14.50 minutes) 78

Personal Tax

Conditions for a company director to qualify for EIS relief

Summary – The FTT found that the shares failed to meet the relevant conditions to get relief

The taxpayer was appointed as a paid director of AR on 1 February 2008. In the previous month, he made a qualifying investment in the company under the enterprise investment scheme (EIS). He made further qualifying investments in July 2008, August 2010, April 2011 and February 2013.

He claimed EIS relief in his 2010/11, 2011/12 and 2012/13 self-assessment tax returns for the shares he bought in 2011 and 2013. HMRC refused the claim and issued a discovery assessment for 2010/11.

The taxpayer appealed.

Decision:

The First-tier Tribunal said HMRC had to establish that the conditions for a discovery assessment had been met. It had failed to do so, so the appeal against the assessment was allowed.

On whether EIS relief was due, the tribunal said the company met the criteria for relief but, because the taxpayer was a director, he was connected to the company and could not qualify unless s169 ITA 2007 applied.

It was accepted that conditions A and B in s 169 were met. However, condition C states that an issue of shares will qualify for relief as long as they are issued within three years of the issue date. The tribunal concluded that the limit expired in January 2011 so the investments made after that date did not satisfy condition C because they had been issued after the taxpayer became a director.

The taxpayer's appeal on the EIS claim was dismissed.

Comments – Like all reliefs conditions exist to get the relief. This decision demonstrates how important it is to ensure that all conditions required to be satisfied by the investor, the issuing company and the 'relevant shares' for the required periods are considered before claiming EIS relief.

N Bell v HMRC TC4969

Travel expenses for a temporary workplace

Summary – The FTT found that the workplace was not a temporary workplace and so the travel expenses were not allowed.

The taxpayer lived in Wales. During 2008/09 his employment was based in Hindhead, Surrey. He claimed travel and subsistence expenses on the basis that this was a temporary workplace. HMRC refused the claim. It said there was no evidence that the taxpayer had been sent to Hindhead for a limited duration.
Decision:

The First-tier Tribunal found there was no evidence to show that the employer envisaged the taxpayer would work at different sites. This was compounded by the fact that he was based at Hindhead for two years without being moved on. The impression was rather that he was expected to work at Hindhead and might have to move elsewhere when his work there ended. This did not happen.

On this basis, the location was not a temporary one. It was his normal place of work and, as such, no travel costs could be claimed.

The taxpayer's appeal was dismissed.

Comments – The travel expenses rules have been around for some time but as this case demonstrates they are not always understood. As readers may be aware they are currently being reviewed but major changes are not expected wen legislation appears.

T Gosset v HMRC TC4821

Treatment of PILON

Summary – The FTT allowed the appeal against a closure notice in part finding that payments made under a compromise agreement were subject to tax as termination payments and taxable in the tax year of payment to the extent that they exceeded the £30,000 threshold.

After several years' employment with ISG, the taxpayer was made redundant. Under a compromise agreement, his termination date was 31 January 2013 and he was paid £15,000 as compensation for loss of employment and £47,521 payment in lieu of notice. The first sum was paid gross, but the employer deducted tax and National Insurance from the other.

The taxpayer allocated the £47,521 across his 2012/13 and 2013/14 tax returns on the ground that it covered a six-month notice period that straddled the two tax years.

HMRC said the whole amount should be assessed in 2012/13 because the sum was paid to him in that year. The taxpayer appealed.

Decision:

The First-tier Tribunal noted that the taxpayer's contract made no provision for payment in lieu of notice. The employer was not therefore entitled to end his employment by making such a payment. On that basis, the payments made to the taxpayer could not be considered emoluments of employment and were not earnings under s62(2) ITEPA 2003. They were instead made in connection with the termination of his employment and were within s 401. As such the first £30,000 would be exempt from tax and National Insurance.

On the taxpayer's decision to split the payment over two tax returns, the tribunal said it understood his logic but the payment had to be taxed in the year it was made.

The taxpayer's appeal was allowed in part.

Comments – This case is another demonstration of the perceived complexity of the tax treatment of termination payments. Following the consultation last year and the Budget announcement we shall have to wait to see what changes occur.

M Phillips v HMRC TC4950

Relief for accommodation allowances

Summary – The FTT found that the accommodation allowances were taxable

The taxpayers were members of a mountain, maritime and coastal rescue team. Their employer paid them an accommodation allowance of £10,000 each. The taxpayers claimed relief for the sums under s336 ITEPA 2003 on the ground that their work required them to live within 15 minutes' drive of their base. HMRC accepted that each taxpayer incurred living costs, but not that they were 'wholly, exclusively and necessarily in the performance of the employment'. It said the housing had a dual purpose and that the expense put the employees in a position to carry out their duties of employment but did not cover the actual performance of those duties.

Decision:

The First-tier Tribunal concluded first that the accommodation allowance should be regarded as earnings under s 62. But the tribunal decided it was not allowable under s 336. There was no express term in the contract of employment that required employees to live within 15 minutes of the base, although there was in ancillary documents. Further, there were sleeping facilities at the base. Being on call at home and undertaking some tasks while there did not 'predominate to such an extent that occupation for the purposes of warmth and shelter (a non-business use) could be said to be merely incidental'.

The taxpayers' appeals were dismissed.

Comments - The FTT disagreed that the appropriate analysis was to equate the position of the appellants with that of employees required to stay in accommodation supplied by the employer, or in respect of which the employer was paying rent directly to a third party landlord. The FTT did not consider that, based on the evidence heard, the occupation of any property by any of the appellants could be said to be 'wholly, exclusively, and necessarily' for the purposes of their employment. As the FTT pointed out, the courts had consistently demonstrated that was a high hurdle to overcome

A Johnstone and others v HMRC TC4979

Charity involved in tax avoidance

Summary - The High Court directed that the interim managers of a charity trust involved in an avoidance scheme should be allowed to discontinue gift aid claims.

As part of a tax avoidance scheme, clients of a tax advice firm had claimed higher rate tax relief on what were portrayed as charitable donations to a trust. In addition, the trust had made claims totalling about £46m for gift aid on the 'donations'. Those gift aid claims had been rejected by HMRC (on the basis that they did not satisfy the requirements of s416 ITA 2007). The Charity Commission sought the sanction of the court (under s78(5)(b) Charities Act 2011) for the interim managers' decision to discontinue the trust's appeal, following leading counsel's advice that the trust's prospects were 'very slim indeed, or negligible'. The advice pointed, in particular, to the fact that the donations formed part of a pre-ordained series of transactions; and viewed realistically as a whole, these only involved the acquisition of a very small amount by the charity. The interim managers had been appointed by the Charity Commission, whilst Mountstar was the sole corporate trustee of the trust and contended that the appeal should not be discontinued.

Decision:

The court observed that there must be a real question as to whether the court should give directions to interim managers; and that it was not 'there to act as a sort of bomb shelter' for interim managers operating under the supervision of the Charity Commission'. However, it found that the exceptional circumstances of the case (the substantial amounts at stake and the public controversy surrounding the trust) justified the involvement of the court.

As for the decision of the interim managers not to pursue the claims, the court found that they had not been obliged to accept the funding which had been offered to them to fight the claims (particularly since it may prove insufficient). It found that their decision to discontinue the claims had been within the range of decisions to which rational charity trustees could properly come, given the very negative advice obtained from counsel.

Comments - In 2013, articles were published in newspapers describing the scheme as 'a massive tax avoidance scam'. An inquiry by the House of Commons Public Accounts Committee had also led to the issue of a report which had concluded: 'it is clear that the trust was set up as a tax avoidance scheme'. In this context, the decision of the High Court is not surprising.

The Charity Commission v Mountstar EWHC

Setting off the personal allowance (Lecture P956 – 10.28 minutes)

Some practitioners may have assumed that the personal allowance (PA) was deducted in a set order i.e. from non-savings income, then savings income with dividend income being the top slice. However, this is not a mandatory set-off order – it was the optimum set off order.

Paragraph – S25(2) ITA 2007 states "At Steps 2 and 3, deduct the reliefs and allowances in the way which will result in the greatest reduction in the taxpayer's liability to income tax." This means you can choose the order of set-off.

From 2016/17 has the optimum order of set off changed?

Three key factors are present in 2016/17 that will influence the personal allowance set off.

1. The £5,000 dividend allowance

A new Dividend Allowance of £5,000, and dividends in excess of the allowance will be taxed at the following rates:

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

The Dividend Allowance is not a deduction in arriving at total income or taxable income. Instead, the first £5,000 of dividend income will attract a zero rate of income tax.

2. Personal savings allowance

A new Personal Savings Allowance (PSA) is to be introduced for individuals for 2016/17 onwards. This will operate in conjunction with the current 0% starting rate for savings and the £5,000 starting rate limit, both of which will continue unchanged.

Also for 2016/17 onwards, banks, building societies and National Savings and Investments will no longer be required to deduct basic rate income tax at source from interest they pay to their customers. Savings income within an ISA will continue to be tax-free, and does not need to be covered by the PSA.

The PSA will be £1,000 for basic rate taxpayers, i.e. those who have no income chargeable at the higher or additional rates or the dividend upper and additional rates. For taxpayers with income chargeable at the higher but not the additional rate (or at the dividend upper but not the dividend additional rate), the PSA will be £500. Taxpayers with income chargeable at the additional rate or dividend additional rate will not be entitled to a PSA. The PSA is not a deduction in arriving at total income or taxable income. Instead, the savings income covered by the PSA will attract a zero rate of income tax.

3. The 0% savings rate

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 which 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.

Personal allowance set off

If you take the example of the income of £22,000 below split into the components below - Example 1 computes the tax in the way that we may have assumed was mandatory.

Example 1

	Total	Non-savings	Savings	Dividend
	£	£	£	£
Total income	22,000	8,500	6,500	7,000
PA	(11,000)	(8,500)	(2,500)	_____
Taxable	11,000	Nil	4,000	7,000

Tax

Savings allowance	£1,000 x nil	Nil
Using savings rate	£3,000 x nil (up to £5,000 at 0%)	Nil
Dividend nil rate	£5,000 (DTA)	Nil
Remainder (excess of dividends over DTA)	£2,000 x 7.5%	150
		150

However because of s25(2) ITA 2007 - the PA can be allocated in any way so try the following

Example 2

	Total	Non-savings	Savings	Dividend
Total income	22,000	8,500	6,500	7,000
PA	(11,000)	(8,500)	(500)	(2,000)
Taxable	11,000	Nil	6,000	5,000

Tax on non-savings	Nil
Tax on interest	
£1,000 PSA	Nil
£5,000 savings rate	Nil
Dividend <£5,000	Nil

This results in a lower tax liability.

If an owner manager is extracting in a similar manner it would be prudent not to set the PA against loan interest where the set-off reduces it below £6,000 (for a basic rate client).

Capital Taxes

Ordinary share capital and shares with no entitlement to dividends

Summary – The FTT found that shares with no dividend rights had a right to a dividend at a fixed rate of 0% and were therefore excluded from the definition of ordinary share capital in s989 ITA 2007.

Mr and Mrs McQuillan (the appellants) established a business in 1999 which they franchised in 2004, incorporating a company for the purpose. Mrs McQuillan's sister and brother-in-law (who also lent £30,000 to the company) became directors and shareholders, holding 17 shares each. The appellants each held 33 shares. In 2006, as part of a condition for raising further finance, the £30,000 loan was converted into redeemable shares with no voting rights and no rights to a dividend. In late 2010, an offer for sale of the company was received and, prior to completion of the sale, the redeemable shares were repaid and a dividend was then paid on the remaining shares. The appellants claimed entrepreneurs' relief but their claim was refused by HMRC on the ground that the company was not their personal company throughout the one year prior to the disposal because the redeemable shares were ordinary shares that caused their holdings to be diluted below 5 per cent.

Decision:

The question to be determined by the FTT was whether the redeemable shares were ordinary share capital, defined in ITA 2007, s. 989 as 'all the company's issued share capital [ ] other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the company's profits'. HMRC argued that a right to no dividend was not a right to a dividend and therefore could not be a right to a dividend at a fixed rate, whereas the appellants argued that a zero rate is a fixed rate, as in the case of a zero rate of VAT. The FTT found the wording of s. 989 to be ambiguous but were influenced both by HMRC's own guidance at ESSUM 43230, which states that shares with no dividend rights may be 'accepted' as ordinary share capital, and continues 'we do not contend that they carry the right to a fixed dividend of 0%', both of which imply recognition of a counter-argument, and by the commercial reality. The appellants could (and possibly would, if the share structure had been established after rather than before the introduction of entrepreneurs' relief) have structured their affairs such that the relief was available whilst still achieving the same commercial consequences. Consequently the FTT accepted that a right to no dividend is a right to a fixed dividend for the purposes of the s. 989 definition and concluded that the redeemable shares were not ordinary shares.

Comment - This decision contrasts with the earlier FTT decision in Castledine [2016] TC4930, in which shares that carried no economic rights to participation in a company were regarded as falling within the definition of ordinary share capital in s. 989 as they did not carry a right to a dividend at a fixed rate.

M McQuillan and E McQuillan v HMRC TC5074

Share loss relief claim

Summary - The FTT determined that the market value of shares should be ascertained as if an investment in the company had taken place.

On 1 March 2011, the taxpayer acquired shares in a company. It ceased trading in May 2011, by which time the shares were worthless. He claimed loss relief under s131 ITA 2007. HMRC refused. The taxpayer appealed.

Decision:

The First-tier Tribunal considered first whether the taxpayer had subscribed for the shares. This turned on whether a loan to the company was from the taxpayer or his son. The tribunal said the evidence on this was confusing and contradictory. It concluded that the loan was from the taxpayer because 'the one clear piece of formal written evidence' on the subject, the minutes of the company board meeting on 1 March, stated the shares had been directly issued to the taxpayer. This was supported by the company's register of shareholders, which also showed there had been no transfers of shares between the father and son.

The tribunal found further that the loan had been converted into shares to prepare the company for an injection of equity from another investor.

On the value of the shares, the tribunal noted that the other investor 'clearly attributed value to the company' and the lack of profits did not concern him. Therefore the shares were not of negligible value when they were issued to the taxpayer but they did become so during his period of ownership. The tribunal decided their market value should be that at the time of acquisition and reduced the amount of share loss relief accordingly.

The taxpayer's appeal was allowed.

Comments – The FTT's decision was made harder in this case by the lack of documentary evidence to support either the loan agreement or the arrangements for subsequent conversion and confusion as to whether the loan had in fact been made to the company or the appellant's son, so that they were obliged to rely on the evidence of what subsequently in fact occurred.

J Lewis v HMRC TC5029

QCBs and redemption in a currency other than sterling

Summary - The UT found that a condition applying to corporate bonds, which provided for their redemption in euros in the event that that the euro became the currency of the UK, prevented them from being qualifying corporate bonds (QCBs).

The issue was whether corporate bonds purchased by Mr Trigg were QCBs, so that they were exempt from CGT under s117 CGTA 1992. The dispute concerned the effect of two types of clauses, which addressed the possibility of the euro becoming the currency of the UK. HMRC contended that these had the effect that the bonds had a provision for conversion or redemption in a currency other than sterling. Mr Trigg argued, however, that in the circumstances covered by the two clauses, the euro would not be a 'currency other than sterling' on the basis that, purposively construed, 'sterling' in s 117(1)(b) should be understood to mean the lawful currency of the UK.

Decision:

The UT would not accept that in s 117, the word 'sterling', whether on its own or as part of the expression 'currency other than sterling', could have any meaning other than the existing lawful currency of the UK — pounds sterling. Parliament had not legislated by reference to any other currency that might, at some future time, become that lawful currency; and, if parliament had wished to do so, it would have done so.

Finally, the UT rejected the argument that the bonds would have been converted by operation of law, in the event that the UK had adopted the euro as its lawful currency. The effect of the relevant clauses would have been to change the character, nature, form or function of the bonds, and thus to constitute conversion of the bonds. The UT added that the purpose of the legislation was to exclude from exemption those securities which contained provisions for conversion or redemption into a foreign currency, except insofar as such provision was in substance no more than redemption at the exchange rate on redemption. The relevant provision for conversion went beyond that, with the result that the exemption was inapplicable.

Comments - The UT highlighted that: 'Even within closely articulated or prescriptive legislation there may be individual provisions which fall to be construed purposively in a way which would be different from a literal construction.' However, it was not for the tribunal 'to fill any perceived gap, or to seek to equate cases on one side of the dividing line with similar cases falling on the other side by reason of similarity in effect or economic equivalence'.

HMRC v N Trigg [2016] UKUT 165

Allowable expenditure and goodwill

Summary - the FTT refused to allow a deduction for expenditure relating to goodwill when computing the CGT due on disposal of a business

Mr Kevin Mulloy (the appellant), who appeared in person, established a business as a combined property managing agent and estate agent/mortgage adviser, which he ran as a sole trader. Six years later, the goodwill of the appellant's business was sold for consideration of £134,100 of which £28,700 was paid to his wife, from whom he was to be separated. (The leasehold of the premises from which he traded was also transferred, but for no consideration as it was about to expire). T

he appellant claimed that amounts that he had invested in the business were a debt owed to him that would not be repaid and therefore should be deducted from the disposal proceeds. Alternatively, he argued that much of the expenditure he had incurred was in fact capital expenditure and should be allowed as a deduction in computing the chargeable gain. He also argued that the amount of £28,700 (which was paid directly by the purchaser to his wife) should not be included in the disposal proceeds, or alternatively should be regarded as a cost of the disposal.

Decision:

The FTT did not accept the argument that there was a debt owing to the appellant by the business. As the business had been conducted as a sole trade, the appellant and the business were one and the same entity, and therefore there could be no debt.

Turning to the second argument, the FTT were prepared to consider amounts previously claimed as trading deductions on their merit (HMRC had argued that s39 TCGA 1992 excluded any sums allowable as a deduction in computing profits, but the FTT pointed out that if such items had been mistakenly allowed, this did not make them 'allowable'). It was agreed that such items were only allowable if of a capital nature, but before considering each item in detail, the FTT sought to establish whether, in principle, they would be allowed under s38 TCGA 1992. The sums involved were principally improvements to the premises and the costs of advertising, training and sundry small items of equipment that the appellant claimed were incurred in respect of goodwill. The FTT did not accept that the costs of improvements to the leasehold premises fell within s38 as they did not enhance the value of the asset (as the leasehold (the asset) was due to expire). In relation to goodwill, they did not accept that the costs were incurred in 'providing' the asset, as the nature of goodwill (other than goodwill acquired with a business as a going concern) is that it is built up over time. The costs also could not be regarded as 'expenditure wholly and exclusively incurred … for the purpose of enhancing the value of the asset' as the expenditure was actually incurred on training, publicity and equipment that were all actively used in the day to day running of the business, nor were they 'reflected in the state or nature of the asset at the time of disposal'.

Finally, the payment to his wife was simply a redirection of some of the proceeds, as there was no evidence that the appellant owned a part of the business as nominee or trustee for his wife (although it was recognised she had made some contribution to the business), as it was made clear in the separation deed that the appellant personally owned all of the business. Moreover, as the payment was clearly made as part of the separation agreement it was not an incidental cost of disposal within s38(2). It was, however, agreed that £500 of legal fees relating to the disposal and mistakenly overlooked by HMRC should be deducted.

Comment - Although many of the arguments raised by the appellant were clearly based on a mistaken view of the law, the case does provide a useful examination of the principles to be considered in relation to allowable costs and non-purchased goodwill.

Mulloy v HMRC TC5019

Disclosure of medical records to determine inheritance tax liability

Summary – The FTT allowed HMRC's application for the disclosure of a deceased taxpayer's medical records in respect of an appeal against an IHT determination.

Lady Edwards-Moss died in February 2007. She transferred a property out of her estate in return for an annuity 17 days before she died. In 2014, HMRC said the transfer was ineffective and issued her executors (her sons) with a notice of determination under s221 IHTA 1984. They appealed and, during the process, HMRC applied for disclosure of the deceased's medical records. The executors opposed this on the grounds of relevance and privacy.

HMRC's alternative objection was that the property had been transferred at an undervalue and therefore failed as a potentially exempt transfer for inheritance tax.

The notice of determination covered the first issue — that no transfer had taken place — so the taxpayers argued that HMRC should not be allowed to argue the second.

Decision:

The First-tier Tribunal referred to the Supreme Court's decision in *CRC v Tower MCashback* that HMRC was entitled to rely on alternative reasoning to support a conclusion. In this case, the conclusion was that inheritance tax was due on the property. Therefore HMRC was entitled to argue that the transfer had been made at an undervalue and the medical records were relevant.

On privacy, the tribunal accepted that taxpayers 'have in general the right to expect their medical records will remain confidential even after their death', but that had to be balanced against the public interest of collecting the correct tax.

In this case, the balance was in HMRC's favour. First, because HMRC had limited the application to recent records relating to the illness that was the cause of the transferor's death.

Second, because the executors had led evidence on the state of their mother's health in the six months or so before her death.

However, the tribunal decided that HMRC's request for five years of records might be excessive and reduced the period to two years. It prepared a draft order to be sent to the GP of Lady Edwards-Moss.

Comments – The FTT allowed HMRC's application for the disclosure of a deceased taxpayer's medical records in respect of an appeal against an IHT determination. It did however limit the period of disclosure to two years prior to death instead of the requested five years. The FTT found that although the determination did not mention the issue to which the medical records were relevant HMRC were entitled to rely on such reasoning in the appeal as the executors were well aware that was an issue between the parties. The FTT found that the public interest in collecting the right amount of tax outweighed the deceased and her family's right to keep her medical records private.

C Edwards-Moss and D Edwards-Moss v HMRC TC4932

Interaction between EIS relief and taper relief

Summary - The Court of Appeal has upheld the Upper Tribunal decision in 2014 that EIS deferral relief was to be claimed against the single gain arising on a mixed use asset with the balance of the gain remaining then apportioned in accordance with the statutory taper relief provisions.

The issue was the interaction between EIS relief and taper relief, in a case in which the asset disposed of had been used both for business and non-business purposes. The taxpayer contended that he could direct his claim to EIS relief to the part of the gain referable to its non-business use; and leave the part of the gain referable to its business use to take greater advantage of the more generous taper relief applicable to disposals of business assets.

Decision:

The Court of Appeal found that the taxpayer's approach was not based on a correct interpretation of the way the provisions were meant to operate. The court observed that CGT was chargeable in respect of chargeable gains accruing in the year of assessment. The effect of a valid claim to EIS relief was that gains were deferred. Thus, taper relief under s2A TCGA 1992 applied to the gains which remained after the application of EIS relief.

Comments - As taper relief was withdrawn for 2008–09 and subsequent tax years, the findings themselves are of limited application. However, it is interesting to note that where s169P TCGA 1992 applies and both entrepreneurs' relief and EIS deferral relief are claimed, EIS relief would clearly be applied to the non-business part of the gain. S169P subdivides the gain into the (business use) part qualifying for entrepreneurs' relief and the (non-business) part that does not so qualify. Sch 5B TCGA 1992, then prevents the gain qualifying for entrepreneurs' relief from being eligible for EIS deferral.

M Stolkin v HMRC EWCA

CGT avoidance scheme

Summary – The FTT found that there had been a single composite transaction that could be characterised as the sale of shares in the market by the trustees that was therefore subject to capital gains tax.

The appeals all concerned a tax avoidance scheme to sell Scottish trust shareholdings in AWG plc without triggering CGT. The scheme involved: the setting up of Irish trusts; the exercise of put options; the purchase and sale of the shareholdings by the Irish trusts; and the replacement of these trustees with the original trustees under the Scottish trusts and the consequent repatriation of these trusts. The issue was whether the scheme should be treated as a single composite transaction for the disposal of the Scottish trust shareholdings.

Applying the *Ramsay* doctrine, the question was therefore whether there had been an expectation that the scheme would be carried through in successive steps, and no likelihood in practice that it would not.

Decision:

The FTT noted that the tax avoidance case law seemed to leave a grey area where the position was to an extent uncertain but not wholly uncertain, as the final decision had been set up so as to rest with a third party that was likely, if not almost bound, to follow the taxpayer's wishes.

The FTT accepted that there had been, at least in theory, a risk that the Irish trustees would take a different view from the Scottish trustees. However, in reality, there had been no practical likelihood of them doing so. The reality had been the sale of the AWG shares in the market by the Scottish trustees and TCGA 1992 was intended to apply to such disposals.

Comments - The scheme in question was designed to exploit the market value rule in s144ZA TCGA 1992 that applies to the exercise price of an option – in fact within days of the scheme being implemented, anti-avoidance legislation was enacted (in s144ZB) that would have caused the scheme to fail. However, the FTT also considered the application of the *Ramsay* principle and its subsequent development in later cases, providing a useful insight into current thinking.

Trustees of the Morrison 2002 Maintenance Trust & Ors [2016] TC 05025

Exploiting the limitations of S67 IHTA 1984 (Lecture P960 – 20.18 minutes)

S67 IHTA 1984 is a special provision that operates in the context of relevant property trusts and the 10-year anniversary charge. It applies if the settlor – after the settlement commenced but before the 10-year anniversary – has made a chargeable transfer as a result of which the value of the property comprised in the settlement has increased.

When calculating the 10-year anniversary tax, instead of starting with the settlor's cumulative total of chargeable transfers for the seven years prior to the commencement of the trust, the trustees must take the settlor's cumulative total of chargeable transfers for the seven years prior to the addition (but only if this figure is greater). If the second seven-year cumulative total brings in the sum originally settled, this amount should be excluded before any comparison is made. There must be no element of double counting. This rule is mandatory.

Illustration 1

On 14 December 1995, Stewart set up a discretionary trust for his godson when his cumulative total of chargeable transfers stood at £135,000.

The trust's first 10-year anniversary fell on 14 December 2005 when the fund was worth £259,000. There had been no exit charges and so IHT of £7,140 was paid by the trustees.

On 3 June 2007, Stewart transferred shares with an IHT value of £302,000 (ie. after deducting his 2007/08 and 2006/07 annual exemptions) to a life interest trust for his younger brother who had fallen on hard times.

Stewart made no other chargeable transfers until 27 August 2008 when he gave the trustees of the 1995 settlement a cheque for £50,000.

In calculating the IHT on the second 10-year anniversary (14 December 2015), S67(3) IHTA 1984 directs that the higher of two possible cumulative totals must be used for this computation:

1. Stewart's original cumulative total of chargeable transfers (£135,000); or

2. Stewart's cumulative total of chargeable transfers for the seven years prior to the addition (£302,000).

In this case, the latter will be taken.

Because same day additions to a relevant property trust are now caught by anti-avoidance legislation (see S62A IHTA 1984 (as inserted by Para 2 Sch 1 F(No2)A 2015)), it will be worth considering the addition of property to pilot trusts on *different* dates. Of course, this may involve aggregation under S67 IHTA 1984 of the earlier additions, but two important limitations of this section should be noted:

- S67 IHTA 1984 only applies to additions made by a chargeable transfer. Therefore, an addition which involves, say, the normal expenditure out of income exemption (S21 IHTA 1984) is not affected.

- Under S67(3) IHTA 1984, what is taken into account is 'the aggregate of the values transferred by any chargeable transfers made by the settlor'. Business and agricultural relief both operate to reduce the value transferred by such transfers. Accordingly, there is still a useful planning ploy if, for example, family company shares are settled on different dates – see (e) below.

<u>Illustration 2</u>

Kevin owns the entire share capital of KP (355) Ltd, a successful company which deals in second-hand sports memorabilia. He has recently received an offer from an Australian entrepreneur to buy the business for £8,000,000 which he is minded to accept.

He plans to put the proceeds into a discretionary trust for some of the younger members of his family.

Unfortunately, this idea has some unsatisfactory consequences. As soon as a binding contract for the sale of Kevin's 1,000 shares is concluded, any thoughts of 100% business relief will disappear. The settlement of the cash proceeds would be a chargeable transfer, giving rise to a substantial IHT liability. And the settlement would be subject to not insignificant 10-year anniversary charges.

A much more tax-efficient solution would be for Kevin to set up, say, 20 pilot trusts of £10 each. He should then transfer 50 of his KP (355) Ltd shares into each of these 20 trusts, with each transfer being effected on a different date. 100% business relief will be available and so each of the consecutive additions will have a zero IHT value.

The sale goes ahead, with the buyer acquiring the shares from the trustees so that a substantial cash sum (£400,000) goes into each of the trusts.

The danger of S67 IHTA 1984 has been avoided and all 20 trusts will benefit from a full IHT nil rate band, going forward.

Contributed by Robert Jamieson

Administration

Bad advice - Interest due as a result of official error

Summary – The FTT allowed the appeal against HMRC's decision that they had not made an official error and that no interest was payable

The company supplied Chinese herbal teas and accounted for output tax on its sales until 2014. HMRC accepted that the supplies should have been zero rated. It refunded the output tax that the taxpayer had overpaid but the company claimed interest on the basis that HMRC had given an incorrect ruling that the supplies were standard rated (s78(1)(a) VATA 1994).

Decision:

The First-tier Tribunal said the onus was on the taxpayer to show that it had overpaid output tax as a result of incorrect advice given by HMRC. The taxpayer referred to three occasions when the department had given it incorrect information:

- correspondence with HMRC in 1994 when it said the supplies should be zero rated;
- a VAT compliance visit in 2004 during which the officer confirmed the standard rate was being correctly applied; and
- a telephone call in 2008 between the company accountant and HMRC's helpline service when, again, the standard rate was confirmed as correct.

HMRC denied any official error, saying its role was not to advise a business on the legislation.

The tribunal agreed that HMRC did 'not ordinarily have a duty to advise a taxpayer of his liability to VAT' but said this changed if a taxpayer specifically asked for advice which it did. HMRC gave incorrect advice and, as a result, the taxpayer continued to account for VAT at the standard rate. Therefore, the taxpayer was entitled to interest under s 78(1)(a).

The taxpayer's appeal was allowed.

Comments - Neil Warren, independent VAT consultant, noted: 'This was a good outcome for the taxpayer. It is accepted that HMRC compliance visits review only aspects of a business's accounting records, so there is little comeback on officers if errors are later discovered. But the key point was that the taxpayer asked the officer for guidance on the liability of its herbal teas in 2004, which convinced the tribunal that an official error had been made.'

Avicenna Centre for Chinese Medicine Ltd v HMRC TC4820

Appeal to continue – FTT Jurisdiction to close a COP9 enquiry

Summary - *The FTT decided various preliminary issues concerning the interaction of self-assessment and corporation tax enquiries, Sch 36 FA 2008 Notices and penalties on the one hand, and possible criminal prosecution on the other*.

HMRC wrote to B, a director of several companies, informing him that it was beginning a code of practice (COP) 9 enquiry into his affairs on the ground of suspected tax fraud.

The department also opened enquiries into B's self-assessment returns and some of the companies' corporation tax returns. It issued notices under Sch 36 FA 2008 for the taxpayer to provide particular documents and information.

The taxpayers applied to the First-tier Tribunal, asking it to order the closure of the COP9 enquiry and the self-assessment and corporation tax enquiries; they also appealed against the Sch 36 notice.

Decision:

At a preliminary hearing, the First-tier Tribunal concluded it had no jurisdiction to close a COP9 enquiry. The tribunal was established under the TCEA 2007 and had no statutory power to close such an enquiry. The enquiry could be challenged only by judicial review.

Another issue for the tribunal was whether article 6 of the European Convention on Human Rights was engaged so as to give B the right against self-incrimination.

The tribunal decided that, because B had been charged with a criminal offence, it was engaged, but not to allow him to refuse to respond to the Sch 36 notice. Nor did article 6 extend to the companies or give them a reasonable excuse for non-compliance with the Sch 36 notices.

The appeal would be listed for a substantive hearing.

Comments - Now the preliminary issues in this case have been dealt with the appeals and applications will be listed for a substantive hearing, so we can expect to hear more about Gold Nuts Ltd and Mr Budhdeo in due course.

Gold Nuts Ltd and others v HMRC TC4875

Underpaid PAYE tax as a result of applying incorrect code

Summary – The FTT allowed a taxpayer company's appeal against HMRC's decision that the company was liable to pay the under-deducted tax resulting from the company's failure to amend a PAYE coding for an employee, finding that the company had taken reasonable care to comply with the PAYE regulations.

The taxpayer failed to amend the PAYE code for B for the years 2011/12 and 2012/13. HMRC issued determinations on the employer to collect the underpayment of tax that resulted. The taxpayer appealed. It claimed to have been generally compliant with the PAYE regulations. Further, similar mistakes had happened with three other employees but HMRC was not pursuing the employer for those underpayments.

Decision:

The First-tier Tribunal said there was 'considerable confusion' about whether HMRC had notified the employer about the coding changes by email or whether it had to check for them on the Revenue's website. HMRC said it had sent paper notices but the employer said none had been received.

Given the 'general high compliance record' of the employer, that HMRC had not taken action to recover the underpaid tax for the other employees, and it was difficult to decide what had gone wrong in relation to the PAYE notices of coding, the tribunal allowed the taxpayer's appeal.

Comments - There was confusion about why the failure occurred. However, given that the company had been an impeccable taxpayer and HMRC had not held the company liable for tax under-deducted in respect of three other employees in similar circumstances the FTT decided that the company had acted with reasonable care and should therefore not be liable to pay the under-deducted tax.

Pendergate Ltd v HMRC TC4956

The effect of the HRA 1998 on UK tax

Summary -The FTT has allowed Mr Fessal's appeal against a discovery assessment under s29 TMA 1970 *and associated penalty under s95, to the extent of reducing the assessments to reflect tax already paid on the same profits in a later tax year.*

Mr Fessal was a barrister and was in the 'transitional regime' applicable to barristers moving from the cash to the true and fair basis of recognising profits for tax purposes under s42 FA 1998 for the three tax years 2005–06, 2006–07 and 2007–08. HMRC opened an enquiry into the 2008–09 tax year and Mr Fessal subsequently resubmitted four years' returns for 2005–06 to 2008–09 which gave rise to an overpayment for 2006–07 and 2008–09 and underpayments for the other two years. HMRC refused Mr Fessal overpayment relief for 2006–07 on the grounds that relief for that year was out of time.

HMRC then raised discovery assessments for 2005–06 and 2007–08 going back six years on the grounds Mr Fessal had been ‘careless’ and still refused to take account of the overpayment claim. Mr Fessal appealed to the Tribunal.

HMRC had previously applied to the FTT in Fessal TC4287 to have Mr Fessal’s claim to extend the time limit for the making of the repayment claim for 2006–07 struck out, which the FTT had allowed, but the FTT had refused HMRC’s application to strike out the appeals against the 2005–06 and 2007–08 assessments.

Decision:

The FTT noted that Mr Fessal was not disputing the amounts of HMRC’s assessments or that HMRC were entitled to raise them. Nor was he challenging the mismatch between the four year time limit for making a repayment claim and six year time limit for raising a discovery assessment. His case was simply that his rights under the *European Convention on Human Rights* (the Convention), art. 1 of Protocol 1 (the A1P1) were breached if the assessments were upheld because taxing him twice on the same profits would deprive him of his ‘possessions’ contrary to A1P1.

The FTT noted the relevant legislation including the A1P1 which stated that a person is not to be deprived of his ‘possessions’; and s3 Human Rights Act 1998, which required that all domestic legislation must be read and given effect in a way which is compatible with Convention rights ‘so far as it is possible to do so’. The FTT further noted that the State had a ‘wide margin of appreciation’ and that domestic tax laws were to be overturned only if ‘devoid of reasonable foundation’.

The FTT then confirmed that it did have jurisdiction (and indeed an obligation) to consider whether the assessments had been properly issued pursuant to s29 TMA 1970 and, in determining that question, was obliged to read the power conferred by s29 as being to issue an assessment which made good the loss of tax but only where assessing that amount did not breach the relevant taxpayer’s rights under the A1P1 to the extent that giving effect to those rights did not go against the ‘grain of the legislation’.

The FTT confirmed (as HMRC had accepted) that the money Mr Fessal would be deprived of by the upholding of the assessments constituted a ‘possession’ and that upholding the assessments would deprive him of that possession. The question was, therefore, whether s29 TMA 1970 without any A1P1 override was within the ‘wide margin of appreciation’ or whether it was ‘devoid of reasonable foundation’.

The FTT noted the arguments in favour of HMRC, particularly that income tax legislation made no provision for offsetting an overpayment for one year against an underpayment in another, and Parliament clearly imposed a four year time limit on repayment claims and a six year limit on assessments where the taxpayer has been careless, and Mr Fessal had been careless.

Against this, however, there were numerous examples of judicial statements to the effect that avoiding double taxation on the same profits was a presumption in applying tax legislation.

Mr Fessal was not claiming that an unrelated overpayment should be offset against an underpayment but that where income has shifted from one year to the next as a result of a discovery assessment, thereby throwing up an overpayment in respect of one tax year which was inextricably related to, and referable to, an underpayment in respect of another tax year, in those circumstances, it would be 'devoid of reasonable foundation' for the assessment in respect of the underpayment tax year not to take account of the tax paid in respect of the overpayment tax year on the profits which are attributable to the underpayment tax year, and further that it did not strike a fair balance between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights for a taxpayer to be required to pay tax twice in respect of the same profits.

The FTT concluded that the amount of the s29 assessment was to be reduced so as not to breach the taxpayer's A1P1 rights by disregarding tax already paid on the same profits (albeit in a different year). The assessment, therefore, remained valid but the amount was to be reduced under s50(6) TMA 1970. The adjustment was to be calculated so as to take into account of the difference in tax rates, personal allowance and band limits in the year in which the tax was paid so as to ensure that Mr Fessal neither gained nor lost from the fact that he paid the tax in a different tax year. The FTT also confirmed the year to which the overpayment was to be allocated and that additionally, an upwards adjustment was to be made so that Mr Fessal did not benefit from a reduction in interest costs by virtue of the allocation of overpayment otherwise resulting in tax being treated as paid before it was actually paid.

Finally, the FTT confirmed the penalties of 5% should be reduced to reflect the adjustments to the amounts assessed but otherwise stood.

Comments - This case considers the application of s29 TMA 1970 and raising of a discovery assessment against the backdrop of ensuring an individual's rights under the European Convention on Human Rights are not breached. The FTT has ruled that taxing Mr Fessal twice on the same income would deprive him of a possession and constitute a breach of his A1P1 rights and as the avoidance of double taxation was an underlying presumption in applying tax legislation, s29 had to be read accordingly. The assessments and related penalties were to be reduced to reflect the tax already paid on those same profits in a different year.

Fessal v HMRC TC5059

Application for closure notice and ill-health

Summary - The FTT rejected an application for closure notice

HMRC opened an enquiry into Ms Carpenter's return, and she refused to provide the requested information before applying for a closure notice.

As Ms Carpenter was seriously ill, she contended that HMRC should exercise its power to close the enquiry on humanitarian grounds, particularly since it had given no reasons to open the enquiry.

Decision:

The FTT found, however, that HMRC was entitled to check a return by opening an enquiry and that it required information from the taxpayer in order to carry out the enquiry. The FTT also noted that HMRC had not issued an information notice because of Ms Carpenter's illness.

Whilst sympathetic to Ms Carpenter's position, the FTT found that it did not justify a direction for the issue of a closure notice in circumstances where HMRC was simply seeking statutory records, which she must have had in her possession and which could be provided without undue effort.

Comments - The FTT commented that if Ms Carpenter provided the information, and HMRC escalated the enquiry into a more intrusive investigation, she should make a further application for a closure notice. The impact of such an investigation on Ms Carpenter's health would influence the tribunal.

C Carpenter v HMRC TC5037

Dispute continues – so referral to the Tax Disputes Resolution Board

Summary – The High Court refused an application for judicial review of HMRC's decision to reject a settlement offer.

The taxpayer applied for a judicial review against the decision of HMRC's Tax Disputes Resolution Board (TDRB) to recommend rejection of the his offer of settlement of a dispute with the authority, which was the subject of an appeal.

The dispute concerned some £16m tax and interest which HMRC claimed was due for the years 2001/02 to 2007/08 (excluding 2006/07). The taxpayer claimed he had been non-UK resident from November 2001 and, as a result, was not liable for UK tax. HMRC and the taxpayer could not agree on the date when he ceased to be resident in the UK and, after unsuccessful mediation, the case was referred to the TDRB. It rejected the settlement on the basis that the Revenue's counsel considered that HMRC had a strong case and should pursue all tax and interest.

The taxpayer said the decision to refer the case to the TDRB was irrational and unfair, as was the board's decision to reject his proposed settlement.

Decision:

Mrs Justice Andrews in the High Court said the function of the TDRB was to scrutinise settlements so that they complied with HMRC policy. The department had warned the taxpayer that the case might be referred to the TDRB if mediation failed.

Further, HMRC was not obliged to give reasons for the referral. The judge said a taxpayer 'should have nothing to fear from a referral to the TDRB' whose job was to ensure a settlement was 'properly reached'.

On the board's decision to recommend rejecting the settlement, the judge said she had 'considerable reservations' whether it was obliged to supply reasons for its recommendations because it was HMRC rather than the TDRB that made the final decision.

Comments – The TDRB may have been concerned about taking a step that might open it to public censure, or been anxious to display an independence of thought. Even if that was the case, however, it did not follow that there was no proper justification for the TDRB's refusal to approve the settlement

The Queen (on the application of J R Charman) v CRC, QBD

Jurisdiction to make cost orders

Summary - The Supreme Court found that the FTT had not had jurisdiction to make a cost order.

The issue was the extent to which the jurisdiction of the FTT to make an order for costs was impacted by the provisions of the Tribunal Procedure (First–tier Tribunal) (Tax Chamber) Rules (the 'rules').

Eclipse's appeal had been allocated as a complex case under rule 23 and Eclipse had served a request that 'the proceedings be excluded from potential liability for costs or expenses' under rule 10(1)(c). As the parties had been unable to agree a bundle, the FTT had directed that Eclipse should prepare the bundles and that the cost of doing so should be shared. Eclipse's agents had sent HMRC invoices for over £100,000, representing half the cost to Eclipse of preparing the bundles. HMRC had applied to the FTT to set aside the oral direction that the parties should share the costs of preparing the bundles, on the ground that the FTT had had no jurisdiction to give such a direction as Eclipse had served a request under rule 10(1)(c).

Decision:

The Supreme Court rejected all of Eclipse's arguments. In particular, it disagreed with the premise that the order had been an order for the sharing of cost as opposed to the payment of cost, since the sharing of costs necessarily entailed their payment. Secondly, it disagreed with the idea that an order under rule 5 could always include a direction as to costs — as such an interpretation 'robs rule 10(1) of much of its force'.

Comments - The Supreme Court found that the order made by the FTT had been precluded by rule 10(1)(c),

Eclipse Film Partners No 35 LLP v HMRC UKSC

Gift Aid Small Donations Scheme - Consultation document (Lecture P 958 – 6.50 minutes)

The consultation opens on 20 April 2016 and closes on 1 July 2016.

At Autumn Statement 2015 the Government announced that – as part of its commitment to encourage charitable giving - it would bring forward the review of the Gift Aid Small Donations Scheme (GASDS) that was scheduled to take place in April 2016.

This consultation sets out specific proposals for how this simplification and accessibility to the scheme could be achieved. It has been informed by conversations with representatives of the charity sector as well as the responses to the Call for Evidence and is intended to gather views on potential reforms to GASDS.
The Government has considered all of the responses received during the Call for Evidence exercise, alongside other representations made by stakeholders, and is pleased to note that charities are generally happy with the scheme and value the additional revenue it provides.

However, the Government is keen to encourage take-up of GASDS, particularly amongst smaller charities, and it therefore proposes a number of changes to the scheme to simplify the rules.

Once any changes are implemented the Government undertakes to work with stakeholders to make the guidance on the scheme as clear and accessible as possible.

Eligibility rules

Charities must meet a number of eligibility requirements to be able to claim under GASDS. For example, it is a requirement that a charity must have been registered for at least two full tax years before it can access GASDS - the 'two-year rule'.

Charities are also required to have made successful Gift Aid claims in at least two out of the four previous tax years with no more than two year's gap between claims – the 'two-in-four rule'.

These rules were designed to make sure that charities demonstrate a reasonable history of compliance with the wider Gift Aid scheme before they are able to access GASDS. While it is important that the link between GASDS and Gift Aid is maintained, the Government understands that these requirements may make it harder for small or newly formed charities to access the scheme.

The Government therefore proposes removing the two-year rule and relaxing the two-in-four rule into a previous year only rule. This change would mean that charities would only need to have made a successful Gift Aid claim in the previous tax year to be able to access GASDS.

Small cash payment rules

The legislation defines a "small cash payment" as a gift of "£20 or less in cash".

The aim of the scheme is to allow a top-up payment without a Gift Aid declaration on small donations. For large donations, charities are more likely to be able to ask the donor for a Gift Aid declaration.
The Government received representations from some stakeholders suggesting that the small donations limit should be increased. However, the Government believes £20 to be a fair amount and broadly in line with what most people would generally consider to be 'a small donation' and it therefore does not propose altering the limit.

The Government does not intend to extend the scope of the regime to include donations made by cheque, text message, or direct debit. The rationale of the scheme is that it enables Gift Aid to be claimed on donations that would otherwise qualify for Gift Aid but are made in circumstances where obtaining a Gift Aid declaration is not practical or feasible. The Government does not believe that this is the case for cheques, text donations and direct debits.

However, the Government recognises that as new technology develops and the charity sector innovates it is important that the legislation continues to reflect the realities of modern fundraising. It will therefore explore with the sector whether donations made via contactless credit and debit cards be brought within scope of GASDS without creating undue complexity or opening up any opportunities to abuse the scheme.

Connected charities and community buildings rules

The 'connected charities' and 'community buildings' rules were designed to ensure that broadly similar results are achieved for 'groups' of charities structured in different ways. Without these rules, it was felt that some charities would be able to claim much less under the scheme than others. The intention is for national organisations, like denominations of churches, to be able to claim similar amounts whether they are structured as a single charity nationally, or as a 'group' structure made up of individual charities.

The Government has become aware that the current rules do not appear to fulfil the original policy intention and therefore remains concerned that some charities are able to claim significantly less than others because of how they are structured.

The Government therefore proposes amending the rules to allow charities or a 'group' of charities to claim either under the main GASDS allowance or under the community buildings allowance, but not both. It would still be the intention that charities receiving donations in multiple community buildings could make multiple claims under community buildings rules but not in addition to the main allowance. In doing this the Government would be adopting the proposal put forward by several respondents to the Call for Evidence as an equitable way to deliver the original policy objective.

Some respondents to the Call for Evidence explained that although their charity is based in a community building, they are unable to benefit from the allowance because most of their collections take place away from the community building.

The Government wants to ensure, as far as possible, that the full spectrum of charities is benefiting from GASDS, and believes that groups that undertake valuable work in their local communities should be able to access the scheme, even when some of the donations are received outside of the community building itself.

Therefore, the Government proposes to explore whether it would be possible in certain circumstances to permit claims under the community buildings rules for donations made outside the community building itself. Consideration would need to be given to any necessary requirements that would ensure the relaxed rules still only benefit collections taking place in the local community.

The community buildings rules would need to be maintained as a measure of real charitable activities delivered through local branches or community groups. While a few respondents to the Call for Evidence proposed that the '10 people' requirement be relaxed, this could risk abuse of more generous community buildings allowances which would undermine the GASDS. The Government is therefore not currently minded to relax the 10 person requirement.

Part surrenders and part assignments of life insurance policies - Condoc

The consultation opens on 20 April and closes on 13 July 2016

The taxation of life insurance policies

Gains on life insurance policies (other than those held by companies) are chargeable to income tax. For events that bring a policy to an end (e.g. maturity or full surrender of the policy) the taxable gain (hereafter referred to as "the gain") is the difference between the cash value received from the policy less the total premiums paid.

Value can also be taken from a policy without bringing that policy to an end. These are called "excess events" and they arise when cash is withdrawn from an on-going policy (a part surrender) or part of a policy is sold (a part assignment).

Current rules allow policyholders to make part surrenders or part assignments of up to an annual cumulative 5% allowance of the premium paid without incurring a tax charge. In these circumstances, any gain is instead accounted for when the policy matures. If the total value received from the policy exceeds the allowance, a gain is brought into charge at the next policy anniversary date ("the end of the insurance year").

For a part surrender, the value received is usually the cash withdrawn from the policy, while for part assignments, it is the surrender value of the part sold at the date of the sale. Gains arising from excess events are deductible from any gain that arises when the policy comes to an end.

To give an example, if a policyholder invests £100,000 in a policy he or she could make annual part surrenders of £5,000 in each of the first 20 years of the policy without incurring a gain chargeable to income tax. Whilst there are no gains at the point of withdrawal, the cash withdrawn is included as a receipt in the final gain calculation when the policy ends. For this reason, this feature of life insurance policy taxation is often referred to as the 5% tax deferred allowance. If, in the example above, the policyholder decided to withdraw £6,000 in any of the first twenty years of the policy instead of £5,000, a £1,000 gain would arise at the end of that insurance year. This £1,000 gain would be deductible from any later gain arising when the policy ends. This feature of life insurance policies has proved very popular with policyholders who can easily calculate what withdrawals they can take from a policy each year without incurring a gain. It also ensures tax parity with a policy where no withdrawals are made prior to maturity.

However, in certain circumstances the current rules can result in gains arising which are disproportionate to the policy's underlying economic gain. In particular this can arise if a policyholder makes a large part surrender (or part assignment) early in the life of the policy. For example, if a policyholder invests £100,000 in a policy he or she could take £5,000 from the policy in the first policy year without incurring a gain. If however the policyholder took £80,000 a gain of £75,000 would arise (i.e. the £80,000 cash withdrawal less the 5% tax deferred allowance of £5,000). This gain is likely to be far larger than the underlying economic gain on the policy; indeed it would arise even if the policy was not in profit.

At Budget 2016 the government announced its intention to change the tax rules for excess events to ensure that such disproportionate gains cannot arise in future. The government announced at Budget 2016 that it would change the tax rules so that disproportionate gains cannot arise from the part surrender or part assignment of a life insurance policy.

Following initial dialogue with policyholder representatives, industry, their representative bodies and the tax profession, the government has identified the following desirable outcomes from any options for change.

- Prevention of disproportionate gains arising from any part surrender or part assignment of a life insurance policy – for both new and existing policies.
- Maintenance of a tax deferred allowance, which is widely understood by policyholders.
- Changes that are simple to administer and understand.
- As few systems changes as possible for insurers.
- Appropriate period of time for insurers to implement the change and explain it.
- A straightforward as possible transition from the current rules to the new rules.
- Avoidance of wholesale changes to the tax rules for life insurance policies.
- New tax avoidance opportunities are not created

There are three possible options for change:

- Taxing the Economic Gain
- The 100% Allowance
- Deferral of Excessive Gains

All of these options are designed to ensure disproportionate gains could no longer arise, and also maintain a tax deferred allowance. The government recognises that there are likely to be differing trade-offs in respect of the other desirable outcomes for each option.

Taxing the Economic Gain

This option would retain the current 5% tax deferred allowance but would bring into charge a proportionate fraction of any underlying economic gain whenever an amount in excess of 5% was withdrawn.

One possible method of calculating the gain in such circumstances would be to deduct a proportionate part of the premium from the amount withdrawn. This deductible amount would be calculated by applying the formula A/(A+B) to the available premium paid where,

A = the amount withdrawn, and

B = the policy value immediately after the withdrawal.

The available premium would be the policy premiums paid less the sum of,

- Earlier withdrawals, to date, which did not exceed the 5% tax deferred allowance, and,
- Any premiums deducted in earlier A/(A+B) calculations.

The formula would only be applied where withdrawals in excess of the cumulative 5% tax deferred allowance are taken. Withdrawals below this level would simply be deductible, in full, from the available premium.

The premium used in any gain calculation cannot reduce the gain below nil.

Although this would require a calculation for each withdrawal, any gains arising in the insurance year would be aggregated and treated as arising at the end of that insurance year. The overall total of the gains could then be reported on one chargeable event certificate to be delivered to the policyholder (and if total gains in the year exceed half the basic rate limit, to HMRC) by the insurer within three months from the end of that insurance year.

A gain arising under this option would always be an appropriate fraction of the policy's economic gain. Unlike the current rules, if the policy was not in profit, no gain could arise from an excess event.

The 100% Allowance

Under this option no gain would arise until all of the premiums paid have been withdrawn. It would change the current cumulative annual 5% tax deferred allowance to a lifetime 100% tax deferred allowance and ensure that only economic gains are taxed.

Once all premiums paid have been withdrawn from a policy any subsequent withdrawals would be taxed in full. Gains would arise at the end of the insurance year and the insurer would be required to report the gain, on a chargeable event certificate, to the policyholder (and if necessary HMRC) within three months from the end of that insurance year.

Deferral of Excessive Gains

This option would maintain the current method for calculating gains but if the gain exceeds a pre-determined amount of the premium (e.g. a cumulative 3% for each year since the policy commenced), the excess would not be immediately charged to tax. Instead it would be deferred until the next part surrender or part assignment.

The gain arising from the next part surrender or part assignment would be increased by the amount of the deferred gain from the earlier event. If this total gain exceeded the pre-determined amount, then the excess part of it would be deferred again (and so on).

On maturity or full surrender the policy gain would be calculated by deducting premiums and gains (whether deferred or not) from total policy withdrawals and any deferred gains would be charged to tax. However if the calculation on maturity etc. did not result in a gain, the deferred gains would be reduced by the amount by which premiums and earlier gains exceed withdrawals (a policy deficiency).

If the policy was assigned, any held over amount would remain with the policy, in the same way that other policy attributes (e.g. premium paid) would follow the policy.

For part surrenders and part assignments this option would not give rise to gains that are linked to the policy's underlying economic gain but it would ensure that disproportionately large gains could not arise on these events.

Tax deductibility of corporate interest– consultation

The government announced that new rules on interest deductibility will be introduced from April 2017 in line with the recommendations set out in the OECD report and taking into account the responses to the initial consultation that closed in January 2016. Due to the importance of this issue, HMRC are publishing this next document now to seek views from all stakeholders on the detailed design of the new rules.

This sets out an overview of the main elements of the proposed new rules.

Application to groups

The new rules will apply on a group-wide basis. The group will include all companies that are or would be consolidated on a line-by-line basis into the accounts of the ultimate parent company. Companies that are not part of such a group will apply the rules in an equivalent way based on the company's own position.

Scope of the rules

The new rules apply to all amounts of interest, other financing costs which are economically equivalent to interest, and expenses incurred in connection with the raising of finance. At the heart of the proposed rules is a UK tax measure of this concept, tax-interest. These are the amounts to which the rules apply and that are potentially restricted.
The rules also require a global accounts-based measure of the same concept, referred to as total group-interest. Other references to interest in this document should be read to also include all financing costs which are economically equivalent to interest, and expenses incurred in connection with the raising of finance.
The interest restriction rules generally apply after all other rules which determine the taxable profit or loss of a company for a period, but before most rules governing loss relief.

De Minimis exclusion

There is a de minimis allowance of £2 million per annum which means that groups with net interest expense below this are unaffected by the rules.

Most groups (and standalone companies which are not part of a group) will readily conclude without the need for any computation that they do not have net tax-interest expense in excess of £2 million, and that they are unaffected by these rules.

Groups that are not excluded by the de minimis rule can nevertheless always deduct at least £2 million of net tax-interest expense per annum, whatever the outcome of the Fixed and Group Ratio Rules. Beyond this, the de minimis threshold has no further impact on the rules.

Fixed Ratio Rule

Subject to the modified Debt Cap rules, deductions for net tax-interest expense are not restricted to the extent they do not exceed 30% of the group's tax-EBITDA. If there is an excess, the group may apply the Group Ratio Rule, which may reduce or eliminate the excess.

The excess may also be reduced or eliminated by utilising any spare capacity brought forward. There is a restriction equal to any remaining excess, which is given effect by reducing deductions for specific items of tax-interest expense chosen by the group. This determines in which companies the restricted interest is carried forward to be treated as an interest expense in future periods.

Modified Debt Cap rule

In addition to introducing the Fixed and Group Ratio Rules, the government wants to retain the existing protection offered by the Debt Cap. So that businesses do not have to apply two sets of rules, the existing Debt Cap legislation will be repealed. Rules with similar effect will be integrated into the new interest restriction rules, such that a group's net tax-interest amounts in the UK cannot exceed the global net adjusted group-interest expense of the group. This modified Debt Cap Rule will strengthen the new rules and help counter BEPS in groups with low gearing, as it will stop some groups with little net external debt gearing up to the Fixed Ratio Rule limit in UK. Any restriction arising from the modified Debt Cap will be treated in the same way as a restriction under the Fixed Ratio Rule.

Group Ratio Rule

The Group Ratio Rule (see Chapter 6), will only be relevant for a small proportion of groups, and its use will be optional. It will allow groups that are highly leveraged for commercial reasons to obtain a higher level of net interest deductions, up to a limit in line with the group's overall position.

The rule will use most of the same mechanics as the Fixed Ratio Rule, but the interest limit of tax-EBITDA multiplied by 30% will be replaced by tax-EBITDA multiplied by the group ratio.

The group ratio will be defined as: Net qualifying group interest expense/Group -EBITDA

These amounts will be calculated using accounting figures for the worldwide group. The interest limit will be capped at the net qualifying group-interest expense. This is also the limit under the Group Ratio Rule if the group-EBITDA is zero or less.

To prevent groups being able to use debt instruments that would not ordinarily attract interest relief in the UK or which have equity-like features to inflate the group ratio, interest arising on such instruments is excluded from the definition of qualifying group-interest. Interest arising on loans from related parties is also excluded, and rules are proposed to treat shareholders that are acting together to secure greater control or influence over the group as related parties.

In some cases, where group-EBITDA is unexpectedly small, the group ratio could be very large, reaching many hundred percent. Similarly, where group-EBITDA is negative, it is proposed that the Group Ratio Rule will permit deductions for tax-interest up to the amount of the whole of the net qualifying group-interest expense. This could give rise to excessive amounts of capacity, which could be used to permit deduction of substantial amounts of restricted interest brought forward. Alternatively, the capacity could be carried forward to allow excessive interest expense to be deducted in the following 3 years.

Public Benefit Infrastructure

The provision of public benefit services often involves a long-term project benefitting from private finance to provide or upgrade, maintain and operate the necessary infrastructure. Projects are often structured so that income and operating expenditure have little volatility, and in consequence it may be both highly geared and generate only a small profit margin over the cost of finance. It is possible that the current project arrangements would become unviable if the tax treatment of interest expense is changed.

Such projects do not present a BEPS risk provided that all the project revenues are subject to UK taxation, and to the extent that the financing is provided by third parties (with no equity interest), is used only for the project, and does not exceed the operator's costs of providing or upgrading the infrastructure. As announced at Budget 2016, the government wants to ensure that the restriction does not impede the provision of private finance in such cases.

In most cases it is expected that the third party interest expense of such projects will be deductible under the Fixed Ratio Rule or the Group Ratio Rule. Where the project gives rise to a finance asset, for example in accordance with IFRIC 12, the resulting finance income will be regarded as tax-interest and therefore netted off interest expenses when applying the interest restriction rules.

In addition, a proposal for a Public Benefit Project Exclusion (PBPE)is set out based on the optional recommendation in the OECD's report. Groups electing to apply the PBPE would identify eligible projects, and would then exclude the eligible tax-interest expense, as well as any tax-interest income and tax-EBITDA connected with those projects, from their interest restriction calculation.

It is proposed that the PBPE would apply where a public body contractually obliges an operator to provide public benefit services, or licenses the operator and thereby regulates, directly or indirectly, the pricing of such services. Public benefit services are considered to be those which it is public policy to provide for the benefit of the public. The PBPE would only apply to interest payable to third parties.

Provision for grandfathering of existing loans or projects would only be made if there is evidence that any adverse impacts of the new rules connected to infrastructure finance would be systemic and could not be mitigated in other ways, and if rules can be designed to limit distortions and preserve the impact of the new rules in tackling BEPS.

Interaction with specific regimes

Profits from the exploitation of oil and gas in the UK and on the UK continental shelf are subject to a special regime known as Ring Fence Corporation Tax (RFCT), which imposes a higher tax burden than the normal corporation tax regime. It includes rules to prevent taxable profits from oil and gas extraction being reduced by excessive interest payments. Budget 2016 confirmed that the new interest restriction rules will not adversely affect existing commercial arrangements within the ring-fence. Two options are set out which are intended to ensure that the new interest restriction rules are effective outside the ring-fence. Under both options, any restriction of interest deductibility would only be applied to activities outside the ring-fence.

The government is continuing to engage with businesses, regulators, the OECD and other countries participating in the BEPS project to understand the extent to which the Fixed and Group Ratio Rules' application to groups with banking and insurance activities could leave interest-related BEPS risks unaddressed. It is considering whether bespoke or modified rules should be introduced for groups engaged in these types of activities. It is envisaged that these rules would have effect from 1 April 2017 and two such options are outlined.

The interest restriction will not reduce or increase the value of Research & Development (R&D) allowances. This will be achieved by ensuring that the actual amount of R&D expenditure, but no enhancement, is included in tax-EBITDA. In contrast with R&D allowances, which are based only on expenditure, the Patent Box is intended to apply a lower effective tax rate to profits falling within the regime. Therefore, the additional deductions in respect of Patent Box profits will be included in the calculation of tax-EBITDA. This will ensure consistent application of the interest restriction and prevent groups that are highly leveraged in the UK getting tax relief at the full Corporation Tax rate for interest on borrowings that are used to generate income that is subject to reduced taxation.

The interest restriction will be designed to work in conjunction with the reforms to loss relief which will become effective on the same date. In broad terms, the interest restriction rules will apply first, and the reformed loss relief rules will apply to the resulting profits and losses. Losses relating to interest expense that arise before 1 April 2017 will not be subject to the interest restriction but will be included within carried forward losses. Interest arising on or after 1 April 2017 that is restricted will be carried forward as interest and subject to interest restriction rules in subsequent periods, but not treated as a carried forward loss. It is possible, though not common, that interest deductible after the interest restriction rules have applied will give rise to or increase a loss. In this case the loss will be subject to the loss relief rules.

Targeted rules

The proposals set out in this consultation are for structural rules backed up with targeted anti-avoidance rules. The government is continuing to review whether additional targeted rules are necessary to apply to particular situations in which deductions for interest would not be restricted under the proposed rules but do give rise to BEPS.

Deadline Dates

1 June 2016

- Due date for payment of corporation tax liabilities for accounting periods ended 31 August 2015 for small and medium-sized companies where payment is not required by instalments.
- Date to check for revised HMRC advisory fuel rates.

7 June 2016

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

14 June 2016

- Quarterly corporation tax instalment for large companies (depending on accounting year end) to be filed by this date.
- EC sales list for quarter ended 30 April 2016 due (paper form) due.

19 June 2016

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

21 June 2016

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

22 June 2016

- Electronic payment of PAYE/CIS liabilities for month ended 5 June 2016 should have cleared HMRC's bank account by this date.

30 June 2016

- Companies House should have received accounts of private companies with 30 September 2015 year end by this date.
- Companies House should have received accounts of public limited companies with 31 December 2015 year end by this date.
- HMRC should have received CTSA returns for companies with accounting periods ended 30 June 2015 by this date.
- CT61 — quarterly period ends.
- VAT partial exemption annual adjustments for March VAT year end to be made.
- Returns by savings institutions made under the European Savings Directive for 2015/16 must be received by HMRC by this date.

HMRC News

230,000 benefit as pension revolution marks one year milestone

HMRC figures published show that over 230,000 people have used the new pension freedoms introduced 1 year ago.

As the government marks the first anniversary of the pension's revolution, the first full year figures released today (Wednesday 27 April) reveal that over 230,000 savers have already taken advantage of the new landmark freedoms.

One year ago (April 2015), the government introduced the most significant pension reforms for a generation giving people who've worked hard and saved their entire lives the ability to access their savings how and when they want.

As the HMRC figures show the new freedoms have already proved to be very popular. In the first year 232,000 accessed £4.3 billion flexibly from their pension pots.

This is alongside the popularity of Pension Wise, the government's free and impartial pension's guidance service, which has already had over 2.2 million visits to the website and nearly 55,000 appointments to date.

The Economic Secretary to the Treasury, Harriett Baldwin said:

It's only right that people should have a choice over what they do with their money and in their first year our successful pension freedoms have already given thousands of people access and responsibility over their hard-earned savings.

We will continue to make sure that the pension freedoms work well for everyone, including through working with our partners to ensure consumers are protected and that there is simple information to help people understand their options.

The government has already taken action to ensure the new freedoms work for consumers and that they have the right information to make informed decisions.

It has announced that it will be capping early exit fees, allowing earlier access to Pension Wise guidance, and working with industry to introduce a Pensions Dashboard.

It has also announced that it is extending the popular freedoms even further, giving millions more people the right to sell their annuities if it's best for them from April 2017.

Since the pension flexibility rules took effect from 6 April 2015:

- 232,000 individuals have accessed their money flexibly
- people have flexibly accessed over £4.3 billion of their own money through 516,000 payments
- in the most recent quarter, 74,000 individuals withdrew £820 million. In the previous quarter, 67,000 individuals withdrew £800 million.
- figures are taken from information voluntarily reported to HMRC by pension scheme administrators from 6 April 2015 to 31 March 2015. It is not mandatory for scheme administrators to flag these up as pension flexibility payments until April 2016
- HMRC statistics cover 'flexible payments', which means partial or full withdrawal of the pension pot, taking money from a flexible drawdown account, or buying a flexible annuity.
- the statistics are available on GOV.UK
- the figures for the current quarter (April to June 2016) will be published in July 2016
- Pension Wise is available online at pensionwise.gov.uk or you can book a telephone or face to face appointment by calling 0800 138 3944

The government will implement all recommendations from the Financial Advice Market Review (FAMR), including:

- consulting on introducing a single clear definition of financial advice to remove regulatory uncertainty and ensure that firms can offer consumers the help they need
- increasing the existing £150 Income Tax and National Insurance relief for employer-arranged pension advice to £500

An insight into key developments with HMRC **(Lecture B959 – 17.00 minutes)**

Relationship with HMRC

At last year's AGM Chris Jones, former President of the CIOT, spoke about the need for the CIOT to strike a good and healthy relationship with HMRC and to be an "honest friend" to them. He was looking for there to be a two-way constructive dialogue between the tax profession and HMRC with both parties being honest, open and to not shying away from the truth. Only then we will we develop a tax system that is transparent and fair to all.

In his validectory speech which will published in the July edition of Tax Adviser, Chris will highlight two key development areas:

1. Making tax digital
2. Relationship with HMRC

Making tax digital

HMRC have some very ambitious plans that many in the profession are concerned about. Chris believes that, although the timings and delivery dates may change, tax will become digital.

In December last year, HMRC introduced the "personal digital tax account" to provide individual taxpayers and small businesses with a personalised picture of their own tax affairs. With time more functionality so as well as email messages, HMRC will be able to inform taxpayers of PAYE codings and you will be able to notify things like changes of address.

At the same time, the Government put forward proposals to "make tax digital for business" and announced plans to introduce compulsory quarterly reporting of financial information to aid compliance and reduce the tax gap.

Quarterly reporting will apply to all small and micro business from April 2018 who will be required to submit records that have been kept on a digital basis. Chris believes that certain taxpayers may struggle to cope if they:

- Do not have access to broadband
- Do not own the required technology
- Are unable to convert to this new digital world

Chris believes that HMRC must ensure that, when they introduce their new rules, they do not force those who currently comply with existing tax requirements to shift and become non-compliers.

Dialogue with HMRC

At present where feedback is given in a constructive way, HMRC appear to be willing to listen and act. HMRC recognize that the tax agent community plays an important role in helping taxpayers comply with ever-increasing complex tax law,

For example, HMRC, in recognising the important role that the tax agent community provide in the compliance process, have now accelerated plans to ensure that the roll out of the new business tax account is dovetailed with providing access to advisers to assist their clients in managing their tax affairs.

Digital record keeping

Where a taxpayers maintains records using recognized software packages, the switch to quarterly reporting will be relatively smooth.

HMRC acknowledge that many small businesses do not keep underlying records in traditional software packages and acknowledge that this will create difficulties in complying with the new quarterly reporting requirements. As a result, HMRC are now exploring ways to accommodate electronic filing from Excel spreadsheets and are looking at ways to ensure businesses will be able to remain compliant where they will genuinely struggle with the new digital environment. Manual ledgers are unlikely to count as 'compliant' but may be covered by an exemption.

The way forward

It is worth spending time now considering 'real life' situations where you see problems in complying in the future, whether that be individual or groups of clients. Look to discuss these issues with other agents to see if there is a potential solution. Once we have seen the consultation document, see if these matters are dealt with. Where they are not, contact your professional body, make your own submission in response to the consultation or contact Chris directly at chris.jones@lexisnexis.co.uk

Business Taxation

Capital or revenue (Lecture B956 – 15.15 minutes)

Expenditure of a capital nature is not allowed as a deduction from trading profits. For both companies and individuals the basis of this derives from ICTA 1988, s 74(1). Following the tax law rewrite, these are now located separately for income tax and corporation tax but the relevant case law is still applicable to both taxes.

The distinction between capital and revenue can be incredibly difficult to make. In some cases it will be impossible to categorically determine whether expenditure is an allowable deduction.

You should avoid having to draw a distinction if it is possible. For example, where any capital element is potentially covered by the annual investment allowance, you should not spend too long worrying whether a revenue expense is allowed.

You should focus on items of expenditure which will not be eligible for capital allowances, such as legal expenses or extraordinary expenditure. Rather than receiving relief through capital allowances, relief will only become available on the disposal of an asset through a chargeable gain calculation.

For larger businesses this risk based approach can be further developed. It is impractical to review all items treated as revenue in the profit and loss account. You should decide an appropriate threshold for expenditure and examine only individual items above it.

In this way you should be able to limit the amount of items you review in preparing a computation or return to only contentious items.

From 2013/14, unincorporated businesses with turnover of less than the VAT threshold (or double the VAT threshold for universal credit claimants), can opt to use the simplified cash basis. This extensively replaces the rules on capital expenditure and receipts.

Definition of capital

The distinction between revenue and capital is often difficult to ascertain and must be determined based on the facts of each case.

In the absence of the statutory disallowance of capital, such expenditure would follow the accounting treatment, in accordance with CTA 2009, s 46 and ITTOIA 2005, s 25. This is because generally accepted accountancy practice (GAAP) does not distinguish between capital and revenue in the same way as required by tax law.

Whilst the accounting treatment will often correctly reflect the nature of the asset in question, it does not necessarily do so. HMRC manuals at BIM35205 and BIM35210 provide references to cases which show how various courts have held this. It is a question of law, not accountancy, as to whether expenditure is capital or not.

Consequently, you should never solely rely on the accountancy treatment as justification for treating expenditure as either capital or revenue unless specific legislation directs you to do so.

Expenditure on a capital asset is not an allowable deduction, even if recognised within the profit and loss account. This is equally applicable to incidental costs, such as legal expenses in purchasing property.

Interest

Interest is not considered to be of a capital nature and should always be treated as a revenue expense. The basis for this was the original wording of ICTA 1988, s 74(1)(f) which specifically prohibited the capital treatment of interest. This was found in *Beauchamp v F W Woolworth plc*. HMRC confirms this at BIM35003 (formerly confirmed in BIM35110) and states that it will not seek to argue that interest is capital.

However, the tax law rewrite has removed the express provision contained at ICTA 1988, s 74(1)(f). For companies, the loan relationship rules determine the treatment of interest. See the Loan relationships guidance note.

For individuals, ITTOIA 2005, s 29 now provides a statutory basis for the treatment of interest as being a revenue expense whatever of the nature of the loan.

Enduring benefit test

Several tests have been developed through case law to ascertain whether expenditure is revenue or capital in nature. The 'enduring benefit' test, which originated from *Atherton v British Insulated & Helsby Cables Ltd*, is one such test.

In this case, that expenditure incurred with a view to providing the business with an 'enduring benefit' was not allowable as a trading expense. 'Enduring benefit' means that the expense will benefit the business not just in the year in which it is incurred, but also in the years that follow.

Tax law does not give any assistance as to how long an asset needs to be owned for it to be classed as 'capital'.

HMRC guidance is that a 'common sense' approach is taken. As a rule of thumb, assets which are expected to be used in the business for more than two years are likely to be capital.

However, HMRC's manuals strictly state at BIM35415 that short life tangible assets should only be accepted as revenue expenditure where the expected life of the asset is less than one year.

HMRC's manuals only refer to a two-year guide at BIM35815 in relation to computer software. This may need further consideration if the value of a short-life asset is high.

In such cases you may only be able to illustrate the outcome of different treatment and advise your client of the possibility and implications of a challenge by HMRC. If the asset has a short life and is likely to be disposed of, consider a short life asset election claim as a means of mitigating a choice to capitalise the asset.

Note that the expenditure must be incurred 'with a view' to an enduring benefit. If ultimately, no asset is acquired as a result of the expense, the expenditure is still capital in nature.

This needs to be distinguished from the identifiable asset test (see below) by considering what the desired effect of the expenditure is.

Identifiable asset test

An identifiable asset needs to be acquired, disposed of or modified in order to be considered as capital expenditure. HMRC cites the case of *CIR v Carron Company*. In the judgment the lack of the creation of a new asset proved crucial in determining the revenue nature of expenditure on obtaining a new charter for the company.

In the judgment of *Tucker v Granada Motorway Services Ltd*, Lord Wilberforce describes how an asset may be identified for the purpose of deciding whether expenditure is capital. Expenditure on the following is capital:

- the acquisition of an asset
- getting rid of a disadvantageous asset, and
- improving an asset to make it more advantageous

In the case of *Carron Company*, it is perhaps hard to see that this does not fall within the latter category. However, it is worth noting that Lord Wilberforce delivered the judgment in both cases, suggesting that the decisions are compatible.

What distinguishes an improvement to an asset to make it more advantageous from 'oiling the machine' is a fine line. HMRC discusses this at BIM35565, but the first line may prove useful in providing comfort in marginal cases:

Expenditure to permit a taxpayer to trade more effectively (and which does not involve the acquisition, modification or disposal of a capital asset) is likely to be on revenue account.

Entirety

UK Courts have settled on the concept of 'entirety' in resolving the issue of what represents a revenue restoration or a capital replacement. Where the entirety of an asset is replaced then the repair is capital, otherwise it is revenue. The question that follows is what constitutes the 'entirety'.

Whilst most pertinent to repairs, this concept relates to all expenditure when determining if capital or revenue. See the Repairs guidance note for further discussion of the specific application to repairs.

Tangible assets

Distinguishing between capital and revenue is most easy to understand in relation to tangible assets. These clearly pass the identifiable asset test. Furthermore, entirety and enduring benefit can be easy to identify.

Whilst not definitive, the accountancy treatment will provide a reasonable guide as to the tax treatment for common trades.

The table below summarises the general advice in HMRC manuals as to the nature of certain payments.

Capital	Revenue
Acquisition of an interest in land – non-property dealing company	Acquisition of an interest in land – property dealing company
Minerals being won from the land	Minerals lying on land
Crops purchased with land – crops yielded annually from trees or other enduring plants	Crops purchased with land – crops sown and harvested annually
Short life tangible assets – useful life greater than one year	Short life tangible assets one useful life less than 1 year
Restoration of capital assets to original condition following use in trade	
Damage to land	Damage to land – annual indemnity payments for damages
Repairs to assets bought in defective condition	Deferred repairs
Repairs that alter function	Repairs including a modern replacement – like-for-like functionality
Notional value of repairs where asset replaced in entirety	

All cases should be evaluated on their individual facts.

Intangible assets

The capital / revenue divide is equally applicable to intangible assets and tangible assets. In fact, it is a much more contentious area, as illustrated by the cases of *Carron Company* and *Granada Motorway Services Ltd*.

The extent of HMRC's guidance on issues of intangible assets is quite extensive and refers to established case law issues. The table below summarises the general advice in HMRC manuals as to the nature of certain payments.

Capital	Revenue
Acquisition of permanent commercial advantages	Acquisition of commercial advantages
Acquisition of business franchises or licences	Acquisition of business franchises or licences – less than two years
Fees in connection with the capital structure of a business	
Profit making structure – fundamental contract	Profit making structure
	Profit making structure – fundamental but not vital
Payment to change existing business or asset structure	Payment to preserve existing business or asset structure
Exclusivity ties – acquiring an interest in land	Exclusivity ties – reimbursed repairs etc
	Changes to company charter
	Cost of an anti-nationalisation campaign
Expenditure in connection with loans and other liabilities	
Incidental expenditure incurred in financing the business	
Release from an onerous agreement – fundamental contract	Release from an onerous agreement – non-fundamental contract
	Getting rid of an unsatisfactory employee
Payment to bind employee with a restrictive covenant	
Compensation for 'sterilising' a capital asset	Compensation for 'sterilising' a revenue asset
Purchase of tipping sites for waste disposal company	

Inducements to enter a lease – before 9 March 1999	Inducements to enter a lease – after 8 March 1999
Cost of incorporating a new company	
Making good dilapidations as a condition of the lease	
Surrender of an onerous lease	
Assignment of an onerous lease	
	Payment to another company to cease production for a period
	Expenditure developing a brand name
	Building society demutualisation
Money injected into a subsidiary as a condition of sale	
Liabilities assumed as part of the consideration for purchase of a business	
Proprietor's training courses – new expertise	Proprietor's training courses – update of existing knowledge

All cases should be evaluated on their individual facts.

Depreciation and amortisation

Depreciation and amortisation is essentially the writing off of a fixed asset from the balance sheet, representing its consumption or use. Depreciation represents the writing off of tangible assets. Amortisation represents the writing off of intangible assets.

Because they are both of a capital nature, neither are allowable expenses for income tax purposes.

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

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

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

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

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

Pre-1 April 2002 goodwill

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

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

Purchases between 1 April 2002 and 7 July 2015l

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

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

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

Clamp down on goodwill acquired on incorporation

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

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

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

The Finance (No2) Act 2015 prevents goodwill amortisation tax relief being claimed on goodwill and customer-related intangibles acquired after 7 July 2015. The (new) s816A, CTA 2009 makes it clear that 'no debits' are tax-deductible for these 'relevant assets', which are defined as:

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

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

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

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

Deciding whether expenditure is capital or revenue

As suggested above, it is usual to develop a suitable risk-based approach to identifying capital expenditure. Where possible, you should disclose this information to HMRC in the corporation tax computation or supporting schedules to a tax return.

However, it can be difficult to determine the nature of some expenses and disclosing them represents a risk. Nonetheless, by providing sufficient information alongside the disclosure, you can minimise the risk of prompting an enquiry and a discovery enquiry in later years.

To determine whether expenditure is capital or revenue, consider the following questions:

- is there a statutory treatment for tax purposes, such as loan relationship or corporate intangibles rules, and
- is there a precedent in case law

The former will definitively determine the tax treatment, whilst the latter will provide a general legal precedent for comparison. In comparing expenditure or considering it without reference to a precedent, you should refer to the following principles:

- is there an enduring benefit
- is there an identifiable asset, and
- does the expenditure represent the replacement or acquisition of an asset in its entirety

A negative response to any might be strongly persuasive as to the revenue nature of expenditure. However, this is not always the case and you should assess each case on its specific facts.

Material kindly provided by Tolley Guidance

Loans to participators (Lecture B957 – 11.27 minutes)

Write-off of close company loans and dividend rates

It is well known that, where a shareholder director of a family business has had a loan from his company which is subsequently written off, an income tax charge arises under S416 ITTOIA 2005 on the amount so released. Prior to the dividend changes which took effect on 6 April 2016, the amount written off was grossed up at the dividend ordinary rate of 10% and further tax (if relevant) was payable by the individual at the difference between 32.5% (or 37.5%) and 10%. In other words, the loan write-off was treated in much the same way as dividend income.

However, what is the effect of the amendments made by FB 2016 on S416 ITTOIA 2005 for 2016/17 onwards? The first point to notice is that Para 18 Sch 1 FB 2016 removes the reference to 'gross' in S416(1) ITTOIA 2005 and repeals S416(2) ITTOIA 2005. This suggests that a close company loan write-off may no longer be taxed at dividend rates, but this is to ignore S19(2)(d) ITA 2007 which states that this form of income is classified as 'dividend income'. Importantly, the subsection has *not* been amended by FB 2016. Therefore, the dividend rates of 0% (for the first £5,000), 7.5%, 32.5% and 38.1% are in point under the new regime.

It should not be overlooked that the charge under S416 ITTOIA 2005 takes precedence over the benefit in kind rules for a loan waiver in S188 ITEPA 2003 where the taxpayer is both a shareholder and a director or employee (S189 ITEPA 2003). This means that the maximum rate of income tax on such a waiver is now 38.1% (rather than 45%).

New rate of charge on company

S455 CTA 2010 ensures that a tax charge arises when a close company makes a loan or advance of money to a person who is a shareholder or an associate of a shareholder in a close company. For arrangements made to which a close company becomes a party on or after 20 March 2013, there is a similar charge under S464A CTA 2010 in respect of benefits conferred on a shareholder (or an associate) that would not otherwise be caught by S455 CTA 2010.

The rate of tax on this charge has been 25% for many years. This mirrors the dividend upper rate. In order to ensure that this remains the position, the rate charged by both sections has been increased to 32.5% with effect from 6 April 2016 (Cl 46 FB 2016). Indeed, instead of being a stipulated percentage, the rate is now specifically linked to the dividend upper rate. The new rate will, in the words of HMRC, 'ensure that Ss455 and 464A CTA 2010 continue to meet their policy objective of deterring close companies from making loans or other arrangements which have the effect of minimising the income tax burden of individuals'.

Contributed by Robert Jamieson

Was a debit allowable under the loan relationship rules?

Summary - The Court of Appeal held that a loan relationship debit arising in respect of a tax avoidance scheme was wholly attributable to an unallowable purpose.

Fidex Ltd, a BNP Paribas group company, issued to Swiss Re four classes of preference share. The terms of each preference share matched those of four bonds held by Fidex and entitled Swiss Re to receive 95% of the cashflows from each bond. Fidex then changed its accounting policy from UK GAAP to IFRS. The effect was that the 2004 UK GAAP accounts recognised both the preference shares and the bonds but the 2005 IFRS accounts recognised neither the preference shares nor 95% of the bonds. The IFRS treatment reflected the economic effect of the arrangement that Fidex had disposed of 95% of the bonds. For tax purposes, the loan relationship rules at the time provided that if a change in accounting policy from one period to the next created a difference in the accounting value of a loan relationship asset then a corresponding debit or credit had to be brought into account in the later period. Fidex Ltd claimed such a debit in the sum of EUR 84m which, if allowable for tax purposes, would have been available to surrender to other companies in the BNP Paribas group.

HMRC issued a closure notice which reduced the amount available for Fidex to surrender as group relief by EUR 84m. The closure notice did not mention the unallowable purpose argument. This was raised for the first time in HMRC's statement of case for the First-tier Tribunal.

Decision:

The Court of Appeal, following the principles established in Tower MCashback LLP v R & C Commrs , held that:

1. The scope and subject matter of an appeal are defined by the conclusions stated in the closure notice and by the amendments required to give effect to those conclusions.

2. What matters are the conclusions set out in the closure notice, not the process of reasoning by which HMRC reached those conclusions.

3. The closure notice must be read in context in order properly to understand its meaning.

4. Subject always to the requirements of fairness and proper case management, HMRC can advance new arguments before the FTT to support the conclusions set out in the closure notice.

It followed that the terms of the closure notice did not preclude HMRC from raising the unallowable purpose issue in the present case.

Regarding the unallowable purpose issue, Fidex argued that the Upper Tribunal erred in law in finding that the whole of the debit should be attributed to the unallowable purpose. It dropped its earlier argument before the Upper Tribunal that the debit could not be attributed to any purpose held by Fidex in 2005.

The Court of Appeal held that the debit arose from and was entirely attributable to the tax avoidance scheme and that but for scheme there would have been no debit at all. The decision of the Upper Tribunal was thereby upheld.

Comments - Regardless of the position in relation to the loan relationship unallowable purpose rules, anti-avoidance provisions would now render this tax avoidance scheme ineffective. The ongoing significance of this decision therefore is its support for the principles established in Tower MCashback LLP v R & C Commrs with regard to the ability of HMRC to advance new arguments before the First-tier Tribunal to support the conclusions set out in a closure notice.

Fidex v RCC EWCA

Did income from diving activities represent business profits?

Summary - The FTT ruled on a preliminary issue that a non-resident diver's income from his diving activities in the UK or UK Continental Shelf, within s15 ITTOIA 2005, fell within art. 7 UK/South Africa DTC

Mr Fowler was resident in South Africa and worked as a qualified diver undertaking diving work in the UK continental shelf sector of the North Sea. HMRC decided that his income from his North Sea diving activities fell within art 14 (income from employment) of the Treaty and were, therefore, chargeable to UK income tax. Mr Fowler contended that his diving income constituted business profits falling within art 7 of the Treaty and were accordingly exempt from UK income tax, since he had no permanent establishment in the UK (within the meaning of art 5 of the Treaty). The issue was firstly whether Mr Fowler had been an employee or a self-employed individual. Even if Mr Fowler had been an employee, s15 ITTOIA 2005 treated the performance of the duties of his employment as the carrying on of a trade in the UK.

Decision:

The FTT pointed out that s 15 was a deeming provision and that the issue was the extent of the deeming treatment. Did s 15 simply have the effect that Mr Fowler must compute his income in accordance with the rules relating to trading income? Or did the treatment deemed by s 15 mean that his income fell within art 7 rather than art 14 of the Treaty?

The FTT noted that the words 'enterprise' and 'business' were not defined terms of the Treaty. Therefore, their meaning, as well as the meaning of 'salaries, wages and other similar remuneration derived … in respect of an employment', must be determined in accordance with UK law, using synonymous UK law terms. The FTT found that the phrase 'profits of an enterprise' within art 7 included the charge to income tax on the 'profits of a trade, profession or vocation' within the meaning of s5 ITTOIA 2015; and that it also included the profits arising from the deemed trade pursuant to s 15. The result of s 15 deemed trading treatment was that Mr Fowler's income that derived from his diving activities constituted profits within art 7 of the Treaty.

Comments - S15 ITTOIA 2005 (Divers and diving supervisors) deems duties of an employment as a diver or diving supervisor in the UK or UK Continental Shelf to be treated as the carrying on of a trade in the UK for income tax purposes. This case considers a preliminary issue as to whether this deeming provision operates to simply have the effect that income must be computed in accordance with the rules relating to trading income or whether it goes further with the result that the income falls within art. 7 (Business profits) rather than art. 14 (Income from employment) of the Double Tax Treaty between the UK and South Africa. The point was critical because if the income fell within art. 7, the UK would not be entitled to tax it but if it fell within art. 14, the UK would be entitled to tax it. The FTT found that art. 3(2) required terms of the treaty to be given their UK domestic tax law meaning unless the context otherwise required (which in this case it did not) and accordingly, the income from the diving activities constituted 'profits' within art. 7.

M F Fowler v HMRC TC5009

Treatment of a trading loss incurred by a partnership

Summary - The First-tier Tribunal found that a tax avoidance scheme designed to fall within s730 ICTA 1988 and thereby protect the recipient of a dividend from a tax charge did not succeed.

The appeal concerned a closure notice denying a trading loss. The dispute related to a £60m dividend received by the partnership from Helios (a company incorporated in the Cayman Islands). However, the partnership contended that this was the income of Dickens Ventures (a company incorporated in the British Virgin Islands), by virtue of the sale of the right to receive that dividend by Dickens to Helios, without any sale of the shares to which the dividends related (s730 ICTA 1988)). The dispute also related to the deductibility of professional fees paid by the partnership for tax advice.

Decision:

The first issue was whether the partnership had been carrying on a trade. The FTT noted that the activities of the partnership in the market were of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in short-dated securities. The artificial transactions involving the Helios dividends meant that the partnership's acts did not unequivocally demonstrate trading. However, as the partnership's subjective intention, as expressed in the partnership agreement, was 'to make a profit other than by means of investment', the partnership was therefore trading.

Secondly, the FTT, applying *Lupton* found that the transactions, by which the partnership acquired the rights to the Helios dividends from Dickens and subsequently received the dividends pursuant to those rights, were not trading transactions carried out with a tax avoidance motive. They were not trading transactions at all.

Thirdly, the FTT found that s730 did not have the effect argued by the partnership. The relevant transactions consisted of three interlocking circular money flows, with the result that the lenders lent funds and recovered them with interest, while retaining control over their funds in the meanwhile by security provisions. The other money introduced to these arrangements consisted of the contributions privately raised by the limited partners, which were all lost, because they were required to fund the costs of the scheme. No real sale of the right to receive the Helios dividends by Dickens to the partnership had therefore taken place within the meaning of s 730.

Finally, given that the Helios dividend transactions were not trading transactions, professional fees paid for tax advice in relation to those transactions were not deductible.

Comments - The Tribunal was considering what was clearly a tax avoidance scheme and, in addition to citing well-known cases such as *Ramsay*, they also cited with approval the comments of Lord Reed in UBS AG v R & C Commrs (a case heard by the Supreme Court after this hearing) that, where a provision had been introduced for anti-avoidance purposes, it 'self-evidently makes it difficult to attribute to Parliament an intention that it should apply to schemes which were carefully crafted to fall within its scope, purely for the purposes of tax avoidance'.

Clavis Liberty 1 LP v HMRC TC5028

Were parking fines deductible?

Summary – Unsurprisingly the FTT found that parking fines incurred by a cash carrying company were not deductible.

G4S was a secure cash transportation company providing cash delivery and collection services. The issue was whether amounts incurred in respect of penalty charge notices were deductible.

G4S contended that deductions were only claimed for penalty charge notices (PCNs) which could not be avoided. G4S additionally argued that it was questionable whether PCNs should be imposed at all, given that certain local authorities did not impose them on cash transport companies.

Decision:

The FTT found, however, that whether PCNs should be imposed was not a matter within its jurisdiction.

The FTT was not persuaded and the fact that a 50% reduction in PCNs had subsequently been achieved suggested that PCNs had been incurred unnecessarily. The FTT also found that G4S had not deployed sufficient resources to seek dispensations.

The FTT concluded that the breach of the law was undoubtedly for commercial gain and was the result of activities in the course of the trade, but it was not part of G4S's trade. Furthermore, a PCN was not paid for the purpose of the trade; it was paid because G4S had a statutory liability to pay it.

Comments - The FTT highlighted that the company G4S did not have to break the law and could have chosen to service customers at times when parking restrictions did not apply. Incurring parking fines was therefore a deliberate choice.

G4S Cash Solutions v HMRC TC5015

Peer-to-peer loans (Lecture P957 – 10.43 minutes)

Peer-to-peer lending is a relatively new type of business arrangement. A provision in FB 2016 has been introduced to put the taxation of income received from such loans on a comparable basis to income received from other economically similar forms of investment.

Peer-to-peer lending sites are, in essence, an intermediary service connecting investors who have money available to lend with individuals or small businesses who need to borrow. The investor puts in a lump sum using the peer-to-peer platform – three of the best known providers are Zopa, RateSetter and Funding Circle – and this is then lent in small sub-loans to a number of borrowers.

The breakdown of the investment into multiple small sub-loans, spreading the risk of default across several borrowers, is the novel aspect which peer-to-peer lending brings to retail investment.

The ability to lend directly to a varied collection of borrowers gives an individual with a peer-to-peer lending portfolio access to diversified lending opportunities which were previously only available to retail investors via collective investment vehicles. Since 2014, provision of these products has been regulated by the Financial Conduct Authority.

Interest arising on peer-to-peer loans is taxed on a current year basis under S370 ITTOIA 2005. The relief in Cl 32 FB 2016 allows investors to set losses incurred on loans which have become irrecoverable against the interest received on other loans which are repaid. The amount of relief is the sum originally lent less any repayments of the loan principal already received. This will result in lenders being taxed on the amount which they receive from their portfolios in a similar manner to the way in which they would be taxed if those loans had been held through a collective investment vehicle.

For 2016/17 onwards, relief will be given automatically for irrecoverable peer-to-peer loans against the income received from other peer-to-peer loans made through the same platform. That is to say, there will be no need for the lender to make a claim in his tax return. By way of illustration, Paul made a series of interest-bearing five-year loans through Zopa in 2015/16.

In 2017/18, one of the loans becomes irrecoverable. The amount of interest which Paul is treated as receiving through Zopa is the aggregate interest from his other Zopa loans in 2017/18 less the unpaid principal of the bad debt.

Peer-to-peer loans which go bad in 2015/16 also qualify for relief, but, in this case, a formal claim must be made.
Investors can make claims to set bad debts in excess of the interest which they receive in the same tax year in one of two further ways:

(i) by making a sideways claim against interest received on peer-to-peer loans made through other platforms; or

(ii) by carrying the amount forward for offset on a FIFO basis against interest received in the next four tax years from any peer-to-peer loans.

As far as the interaction with an individual's personal savings allowance is concerned, the allowance applies to interest received in connection with any peer-to-peer lending, but only after deducting relief for bad debts. In other words, the bad debt relief in Cl 32 FB 2016 takes precedence.

Contributed by Robert Jamieson

Failure to make construction industry scheme deductions

Summary – The FTT substantially allowed a taxpayer's appeal against CIS liabilities and penalties.

The taxpayer was the director of two nursing homes. He wished to make improvements to one and entered into contracts with three construction workers to carry out the work. HMRC said he should have made deductions under the construction industry scheme when paying the contractors and imposed a penalty.

Decision:

The First-tier Tribunal said this was a 'strange' case because, had the nursing home company engaged the builders there would have been no liability on its part to make deductions in the same way as there is no liability on the part of a home owner when they pay for building work on their house.

Further, the invoices were issued to the nursing home rather than the taxpayer, suggesting that he was 'simply acting in his role as a director of the non-construction company' that was receiving the services.

However, the tribunal said it accepted the premise of the appeal — that the taxpayer was liable to comply with the construction industry scheme. With regard to one of the subcontractors, the director said he had told him that he was self-employed and registered with HMRC. It had 'never occurred' to him that he would have to make deductions from the payments.

The tribunal said the taxpayer had not considered his obligations under the construction industry scheme but concluded there was no want of reasonable care in failing to comply.

This was because:

- it was 'entirely understandable' that the taxpayer, having considered and correctly rejected the issue of deducting tax under the PAYE regulations, would be unaware of any other potential obligation to deduct tax at source;
- unlike a trader in the construction industry who would have been aware of the scheme's regulations, the taxpayer was someone who would have been most unlikely to have heard of them; and
- he had checked the subcontractor's tax status.

The tribunal concluded that the taxpayer was not liable for the construction industry scheme deductions and that the penalty should be quashed.

The taxpayer's appeal was allowed.

Comments - Although the taxpayer failed to make deductions under the CIS scheme there was no ‘want of reasonable care’ and for the vast majority of payments the failures were made in good faith and there was a genuine belief that no deductions were required. The penalties were quashed because of ‘special circumstances’.

E Donnithorne v HMRC TC5017

Intra-group swap transfer and closure notice

Summary – The Court of Appeal upheld the decision of the Upper Tribunal that para 28 Sch 26 FA 2002 did not apply to the intra-group novation of in-the-money derivative contracts which meant that the profit arising on the novation was not disregarded for tax purposes. The Court of Appeal also overturned the decision of the Upper Tribunal that the issue of a closure notice in error precluded the making of the adjustments required to give effect to the first part of the judgment.

In August 2003, Bristol & West plc (B&W) transferred a swap contract to its sister company, Bank of Ireland Business Finance (BIBF), for £91m, intending to take advantage of a loophole in the derivatives transitional provisions in FA 2002. This had changed the tax rules for the swap from an accruals to a mark-to-market basis.

The new regime applied to a company's first accounting period beginning on or after 1 October 2002. B&W's accounting period began on 1 April 2003, so was in the new regime, but BIBF's accounting year began on 1 September 2002, so was outside it when the transfer took place. The aim was to rely on the rollover rule in para 28, so that the £91m paid to the taxpayer would disappear from B&W's accounts but not reappear in BIBF's accounts.

HMRC said para 28 did not apply and opened an enquiry in November 2005. On 31 October 2007 it mistakenly issued a closure notice stating no adjustments were necessary. It emailed the taxpayer about the error on the same day. In November it confirmed the position in writing, saying the return would be amended.

The First-tier dismissed the taxpayer's appeal. The Upper Tribunal upheld the First-tier Tribunal's decision but allowed the taxpayer's appeal on the closure notice mistakenly sent to the company. HMRC appealed and the taxpayer cross-appealed.

Decision:

Lord Justice Briggs in the Court of Appeal said the email had invalidated the October notice. On the November letter, 'applying practical common sense', the judge was prepared to assume that it 'read alone or with the October notice to which it referred, did communicate a clear message that HMRC had completed its enquiry'. But, because it did not include any of HMRC's conclusions, the reader was left 'in hopeless confusion'.

The October notice had said no amendment was required but the November letter said HMRC intended to amend the return, but without giving details of the form the amendment would take. The judge said for this reason the November letter was not a valid closure notice in its own right.

HMRC's appeal on the closure notice issue was allowed.

On the para 28 issue, the court said the purpose of the legislation was to achieve tax neutrality in intra-group transfers. It concluded that it could operate only when both the transferor and transferee companies came within its scope.

The taxpayer's cross-appeal was dismissed.

Comments –The transactions in question took place in 2003 when the legislation in question was found in para 28 Sch 26 FA 2002. This paragraph was amended as regards transactions carried out on or after 16 March 2005, so that the para. 28 disapplication issue no longer arises in practice. The provisions have since been re-enacted in s625 CTA 2009.

Bristol and West plc v CRC, Court of Appeal

Finance costs related to residential property businesses (Lecture B958 – 12.05 minutes)

At present, full income tax relief is normally available for interest paid on a loan taken out by a taxpayer for use in his property letting business. The funds may have been spent in:

- purchasing the rental property;
- making improvements to it;
- providing furnishings and equipment (cookers, fridges and washing machines) for tenants; or
- helping to finance the working capital of the business.

S24 F(No2)A 2015 introduces a restriction on the deductibility of these expenses and provides instead for a tax reduction for such costs, limited to the basic rate of income tax only. In the words of HM Treasury, this is to 'ensure that landlords with higher incomes no longer receive the most generous tax treatment'. However, in order to give taxpayers time to adjust, the legislation introduces the change over a four-year period.

With effect from 6 April 2017, landlords will be unable to deduct all their interest and other relevant finance costs from their property income in order to arrive at a figure for their letting profits.

This is to be phased in as follows:

(i) In 2017/18, the deduction from property income will be restricted to 75% of the finance costs, with the remaining 25% being available as a basic rate tax reduction.

(ii) In 2018/19, there will be a 50% finance costs deduction, with the other 50% given as a basic rate tax reduction.

(iii) In 2019/20, there will be a 25% finance costs deduction, with the other 75% given as a basic rate tax reduction.

(iv) For 2020/21 onwards, all finance costs incurred by a landlord given as a basic rate tax reduction.

See S272A ITTOIA 2005 for the full details relating to the progressive restriction of this relief. The meaning of what F(No2)A 2015 terms the 'costs of a dwelling-related loan' is in S272B ITTOIA 2005.

Note that these rules do not apply to owners of furnished holiday accommodation nor to landlords of rented commercial property.

For each tax year, the income tax reduction will be calculated as 20% of the lowest of:

(i) the taxpayer's interest and other relevant finance costs;

(ii) the profits of the property letting business; or

(iii) the taxpayer's 'adjusted total income', ie. his total income minus any savings and dividend income and after deducting his personal allowance.

Any unrelieved amounts can be carried forward to the following tax year (and so on).

Cl 26 FB 2016 has replaced Ss274A and 274B ITTOIA 2005 (which explained how to calculate the tax reductions for, respectively, individuals and accumulation or discretionary trusts) with four new sections which contain considerably more detail. They are:

(i) S274A ITTOIA 2005 (which sets out when an individual is entitled to a basic rate tax reduction);

(ii) S274AA ITTOIA 2005 (which makes provision for how an individual's basic rate tax reduction is to be calculated);

(iii) S274B ITTOIA 2005 (which explains when the trustees of an accumulation or discretionary trust are entitled to a basic rate tax reduction); and

(iv) S274C ITTOIA 2005 (which establishes the procedure for the computation of the basic rate tax reduction for trustees of accumulation or discretionary trusts).

This revised measure:

(i) puts beyond doubt that individual beneficiaries of deceased persons' estates are entitled to the basic rate tax reduction;

(ii) ensures that the 'adjusted total income' restriction applies where the relevant finance costs or property letting profits are higher than the taxpayer's 'adjusted total income' (see (e) above); and

(iii) confirms that a tax reduction carried forward is given in any subsequent tax year in which property income is received, even if there is no restriction on the deduction of finance costs in that year (because, for example, the loan has been repaid).

A letting activity which has relatively modest interest outgoings will not be too badly affect by this new regime, but, as one commentator has remarked, 'larger property businesses using debt to expand the portfolio will find that their business model has been seriously undermined'.

It is for this reason that many clients are giving serious consideration to the possibility of incorporating their property letting businesses in order to mitigate the adverse effect of S24 F(No2)A 2015. Corporate landlords can still obtain full tax relief for their interest payments.

Contributed by Robert Jamieson

Extended averaging for farmers (Lecture B959 – 17.05 minutes)

The Government's plan

It was announced on 18 March 2015 that the Government planned to extend the period over which farmers can average their profits for income tax purposes from two years to five with effect from 6 April 2016.

Following consultation, the Government have decided to retain the existing framework which provides for the averaging of fluctuating profits over two years (albeit with modifications) and to offer an additional option of averaging over a five-year time-scale. The revised legislation is set out in Cl 25 FB 2016.

The original averaging rules

Where, for two consecutive tax years, the profits of a farming sole trader or partner for one year did not exceed 70% of the profits for the other, a claim could be made to adjust those profits to a simple average of both years. If either year's profits exceeded 70%, but were less than 75%, of the other's, a special partial averaging formula was applied.

The new regime

For 2016/17 and subsequent tax years, the marginal relief formula provided by S223 ITTOIA 2005 has been removed so that full averaging is now available where the profits of one year are less than 75% of the profits of the other. There can be no averaging if the profits of one year are equal to, or greater than, 75% of the profits of the other (S222(1) ITTOIA 2005).

It is still the case that, if a farmer makes a loss in one of the years, this counts as nil for averaging purposes (S221(5) ITTOIA 2005). The profits to be considered (known as 'relevant profits' in ITTOIA 2005) are the adjusted business profits after capital allowances but before any deduction for loss relief. With partnerships, it is the partner's profit shares which are averaged, and not the partnership profits as a whole – thus an averaging claim by one partner has no effect on any of the other partners.

However, the more important change in Cl 25 FB 2016 is the alternative facility under which farmers can average their profits over a five-year period, subject to meeting a so-called 'volatility condition'.
By virtue of new S222A ITTOIA 2005, this means that a five-year averaging claim can be made if either of the following is less than 75% of the other:

(i) the average of the profits for the first four tax years to which the claim relates; and

(ii) the profits for the last of the tax years to which the claim relates.

Alternatively, a five-year averaging claim can be competent if the profits of one (or more) of the tax years to which the claim relates are nil.

Illustration

Giles has been in business as an unincorporated farmer for many years. He has relevant farming profits in the following tax years amounting to:

	£
2012/13	50,000
2013/14	28,000
2014/15	26,000
2015/16	40,000
2016/17	96,000

Under the original provisions, Giles claimed to average the results of 2012/13 and 2013/14 so that his taxable profits became £39,000 for each of the two years.

Giles then averaged the results of 2013/14 (£39,000) and 2014/15 (£26,000) so that his taxable profits became £32,500 for each of the two years.

No averaging claim was available for 2014/15 (£32,500) and 2015/16 (£40,000).

Clearly, the results of 2015/16 and 2016/17 can be averaged under the two-year rule so that Giles' taxable profits would become £68,000 for each of the two years.

As far as five-year averaging is concerned, Giles meets the volatility condition. Although there are no losses, the average of the relevant profits for the first four tax years (£50,000 + £28,000 + £26,000 + £40,000 = £144,000) is £36,000. This figure is less than 75% of the 2016/17 profits (£96,000). If Giles opts for five-year averaging, the profits for each of the tax years 2012/13 to 2016/17 (inclusive) become £48,000.

In order to enable Giles' tax adviser to evaluate whether there should be a claim for five-year averaging, a claim for two-year averaging or no claim at all, it will be necessary to consider the numerous combinations possible with regard to Giles' circumstances.
The adviser will need to take into account that profit averaging is a continuous process and so he may have to include the results of prior and subsequent tax years. This will involve calculating the income tax and Class 4 NICs payable under each of the options, the implications of full or partial capital allowances claims (or no claim) and the impact of all this on Giles' other income and reliefs.

There are slightly surprising commencement rules in Cl 25 FB 2016. S222A ITTOIA 2005 has effect from 2016/17 onwards, meaning that a five-year averaging claim with 2016/17 as the final tax year would entail averaging the profits of 2012/13 to 2016/17 (inclusive) – see (g) above. The amendments to the two-year averaging provisions have effect when the later year is 2016/17 or a subsequent tax year.

Conclusion

The extension of farmers' averaging to five years will help them to manage the impact of volatile profits caused by outbreaks of disease, fluctuating global prices and adverse weather conditions. Some will be disappointed that the new regime applies for a fixed period of five years rather than for any period up to a maximum of five years.

However, given that two-year averaging is to remain (and this was a strong recommendation from the NFU during the consultation process), it seems a sensible balance between the need for more flexibility and the importance of keeping things reasonably simple. The abolition of marginal relief for farmers using two-year averaging is a welcome simplification.

Contributed by Robert Jamieson

Claim to set farming losses against other income

Summary – The FTT dismissed a taxpayer's appeal against a closure notice amending his 2011–12 tax return and discovery assessments for 2009–10, 2010–11 and 2012–13 disallowing his claims for sideways loss relief in respect of his farming losses. The FTT found that HMRC were entitled to make the discovery assessments and the taxpayer had made losses in the previous five years and did not meet the reasonable expectation of profit test.

HMRC enquired into the taxpayer's 2011/12 return asking why his farming losses had not been restricted under s67 ITA 2007 because the business had made losses for the previous five years.

The taxpayer confirmed that losses had been made since 2004/05 but said only those for 2007/08 to 2010/11 had been set against other income. The 2011/12 losses had therefore not been restricted because only those of the previous four years had been claimed.

He said the five-year limit should be extended under s 67(3)(b) because he had changed from dairy to beef farming and had a reasonable expectation that better beef prices would make the business profitable.

HMRC said, regardless of the change of emphasis from dairy to beef, the trade was the same and asked for more information about the future of the business. The taxpayer said it would be difficult and expensive to supply figures showing a reasonable expectation of profit, but suggested that 2013/14 may show one.

The matter proceeded to the First-tier Tribunal.

Decision:

The judge said it was the taxpayer's responsibility to provide proof that s 67(3)(b) should apply. In this case, the farming activity had to be related back to the previous loss period (s 68 (3)(b)), which was 1 March 2004. The question was 'would a competent farmer expect to be in profit by 2011/12?' The taxpayer had provided no evidence to show he would. Therefore the loss relief period could not be extended beyond five years and farming losses could not be set against other income in 2009/10 to 2012/13.

The taxpayer's appeal was dismissed.

Comments – One of the appellant's arguments was that although he had made farming losses for more than five years, as he had only set them against other income for the previous four years, he had not met the 'five year rule' in s67(2) ITA 2007 and therefore should have been allowed sideways loss relief. However, according to the wording of s67(2) the issue is whether profits have been 'made' not whether losses have been 'claimed'.

A Ashcroft v HMRC TC4962

VAT

Recovery of input tax incurred on production of a report

Summary - The Supreme Court found that Airtours was not entitled to recover input tax in relation to a report prepared by PwC and paid for by Airtours.

This case has finally reached the Supreme Court. The matter at issue was whether Airtours was entitled to recover input tax in respect of services provided by PwC and paid for by Airtours. This in turn depended on whether the services provided by PwC had been supplied to Airtours.

Airtours, which had borrowed money from around 80 banks, had been in serious financial difficulties and had sought refinancing. It had commissioned PwC to produce an accountants' report to satisfy the banks that its restructuring proposals were viable.

The first issue was whether PwC had contractually agreed with Airtours that it would supply services to it, such as providing a report to the banks. The second issue was whether the facts that Airtours had a substantial commercial interest in the services being provided by PwC to the banks, and that it had agreed to pay PwC for the services, led to the conclusion that the services were 'supplied' to Airtours (as well as to the banks).

Decision:

The Supreme Court found that PwC's obligation to provide its services was owed solely to the banks; and that Airtours was a party mainly for the purpose of agreeing to pay PwC's fees. The court found that the benefit which Airtours received was not the services from PwC, but the enhanced possibility of funding from the banks.

Comments – It should be noted that two Lords dissented and in their view, the real issue was whether, on the facts, the arrangements between the banks, PwC and Airtours involved the supply of services to Airtours or merely third party consideration provided by Airtours for services rendered to the banks alone. Airtours' future had depended on the report, so that the value of the services provided by PwC was as great to Airtours as it was to the banks. They concluded that a tripartite agreement had been entered into and that PwC had owed a duty of care to Airtours.

Airtours Holidays Transport v HMRC UKSC

Application for judicial review of decision to change VAT calculation method

Summary – The Upper Tribunal dismissed the Claimants' application for judicial review of a decision issued by HMRC on 26 November 2014 requiring the Claimants to change the way in which they calculated the proportion of the monthly charge to customers for network access used and enjoyed outside the EU.

Telefonica Europe plc and Telefonica UK Ltd provided mobile telecommunications services to business and private customers in the UK. Supplies to private consumers were made on a 'pay as you go' basis for which customers paid in advance for the services used or under a contract for monthly payments in arrears.

Between 2008 and 2014, Telefonica, in agreement with HMRC, used a Revenue methodology. First it determined what proportion of the charges paid by the customer for additional services in a month related to those used in non-EU countries compared with total charges paid by the customer in that month for the time spent and number of texts sent. Telefonica then applied that proportion to the network access charge and treated the amount not subject to VAT.

In November 2014, HMRC decided the revenue methodology was distortive because customers on the relevant tariffs paid more for non-EU additional services than for those in the UK and EU. That difference in the tariff meant the charges for non- EU additional services were a higher proportion of the total cost of additional services than the volume of non-EU additional services compared with their overall volume.

HMRC said Telefonica should calculate the proportion of the monthly network access charge that related to non-EU access by reference to actual usage of the supply — the usage methodology. This would result in a smaller proportion of the monthly network access charge being treated as relating to services used outside the EU and therefore not subject to VAT.

Telefonica applied for judicial review on three grounds. First, the usage methodology was unlawful because it was contrary to EU and domestic VAT legislation. Second, the decision breached the taxpayer's legitimate expectation that it could continue using the revenue methodology until there was a change in the law or in Telefonica's business. Third, the decision had been taken without adequate consultation.

Decision:

On the first ground, the Upper Tribunal said both methodologies relied on the customer's actual chargeable use of networks. They also relied on comparing the proportion of actual access to the overseas networks with the total actual access to all networks over the month for which the access charge was imposed. Nothing in the legislation precluded an approach to determining use and enjoyment based on actual usage. Therefore, the usage methodology was not unlawful.

On the legitimate expectation point, the judge said there had not been a wholesale change of methodology. Further, nothing in the communication between Telefonica and HMRC could be regarded as stating that the taxpayer could use the revenue methodology for ever.

Finally, the tribunal said HMRC had had a duty to consult Telefonica about the proposed change to the agreed methodology. HMRC would have been aware of the financial benefit to Telefonica of using this. As a result, the company had a legitimate expectation that HMRC would not require it to use another methodology without consultation. However, the judge found that HMRC had consulted properly. It had provided Telefonica with an adequate opportunity to make representations and explain why it could not implement the usage methodology.

The taxpayer's application for judicial review was dismissed.

Comments - This case is highly very fact specific, but it is a helpful reminder of the hurdle that must be overcome in order to successfully demonstrate a breach of legitimate expectation (of either kind) by a claimant. The decision includes a comprehensive and up-to-date analysis of the relevant cases on the subject. As the assumed income which would be lost by Telefonica is in excess of £11m, it would be surprising to not see an appeal being made to the Court of Appeal.

R (on application of Telefonica Europe plc and another) v CRC, Upper Tribunal

Too vague an estimate - Rules for exception from VAT registration

Summary – The FTT found that HMRC's decision was reasonably reached

The taxpayer was a consultant gynaecologist employed by the NHS. He made exempt supplies through his private medical practice but he also had taxable income from producing legal reports in his capacity as an expert witness. The medical legal work income exceeded the registration threshold for the first time in October 2013.

The taxpayer wrote to HMRC requesting an exception to being registered because his expected income for the 12 months beginning 1 December 2013 would be less than the deregistration threshold of £77,000. He explained this was because he was due to retire in August 2014.

HMRC refused the exception application on the basis that the predicted turnover was below the threshold only because the taxpayer did not intend to trade for the entire 12 months. This approach is supported by para 4(2) Sch 1 VATA 1994 which states that a person 'shall not cease to be liable to be registered' if HMRC is satisfied that the reason the value of his taxable supplies will not exceed the deregistration registration threshold is that 'in the period in question he will cease making taxable supplies, or will suspend making them for a period of 30 days or more'.

The taxpayer appealed. He confirmed that actual turnover to August 2014 was £61,605, but additional turnover of £10,500 was projected for September to November, making the total £72,105 which was below the deregistration threshold.

However, the existence of sales in September to November contradicted the taxpayer's claim of retirement at the end of August 2014 and HMRC decided that expected sales of £65,000 when requesting an exception was too close to the deregistration threshold. Therefore it could not justify an exception.

Decision:

The key question for the First-tier Tribunal was whether HMRC's action in refusing to grant an exception was reasonable.

The tribunal said it was reasonable for HMRC to conclude that the margin between the estimated turnover of £65,000 and the deregistration threshold of £77,000 was close and that a greater degree of certainty for the projected turnover was required. HMRC's decision was reasonably reached.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, commented: 'Given that all of the taxpayer's customers were legal firms who could claim input tax on his fees, it would be expected that he would be happy to register for VAT to reduce his costs by claiming input tax.

As a separate point, advisers should be clear that, when applying for an exception, the relevant issue is the known facts at the time of the request, ie when the limit was exceeded, rather future events.'

G Lane v HMRC TC4815

Retrospective entry to the flat rate scheme

Summary – HMRC had acted reasonably in refusing retrospective entry to the FRS

The taxpayer, a solicitor, applied to join the VAT flat rate scheme on 6 May 2014 but requested that it be backdated to 1 July 2012. HMRC refused to allow him retrospective use of the scheme and said he could use it from 1 March 2014.

The taxpayer appealed. He said HMRC's approach of treating the scheme as a way of 'simplifying' VAT accounting was flawed and that taxpayers would take advantage of it only if it had a tax beneficial or neutral outcome.

Decision:

The First-tier Tribunal said HMRC had acted reasonably in refusing to backdate the taxpayer's entry to the scheme. The Revenue's position was clear: retrospective entry was not allowed for periods when the applicant had already calculated his VAT liability. The aim of the scheme was to reduce the administrative burden of dealing with VAT, not help taxpayers reduce their VAT bills. The taxpayer's appeal was dismissed.

J Goodman v HMRC TC4827

Were timber structures caravans?

Summary – The FTT dismissed the appeal against HMRC's decision that zero-rating did not apply to supplies of mobile timber structures

This was an appeal against HMRC's decision that supplies of timber frame structures should not have been zero-rated but standard-rated. In order to qualify for zero-rating, the supplies of the three structures had to be of 'caravans' that satisfied the size and weight conditions referred to in Item 1 Sch 8 Group 9 VATA 1994 and were manufactured to the standard BS 3262:2005. The parties agreed that both conditions were satisfied and that the issue was whether they were 'caravans'.

The FTT observed that the full definition of 'caravan' in the Caravan Sites Act 1968 was not appropriate for this purpose. It also noted that the purpose of the zero-rating was described in the notes to FA 1972 as being to give residential caravans the same relief as houses. The issue was whether the three structures in question had been designed or adapted for human habitation so that they were equipped with facilities for use as residential caravans. As the three structures had been erected and configured as classrooms, they could not be described as residential caravans.

Comments - The planning applications for the two of the school structures included a statement that the proposal did not involve the gain or loss of residential units, which probably affected the FTT's decision**.**

Thermo Timber Technology v HMRC TC5013

Partial exemption methods and groups

Summary - The FTT found that HMRC had been wrong to consider that a PESM automatically ceased on the trader joining a group.

Dynamic People had agreed with HMRC, a PESM based on floor space, at a time when it was not a member of a group. When Dynamic People joined a group, HMRC indicated that it was necessary to agree a new PESM. Dynamic People therefore proposed a new PESM which, according to the FTT, was substantially the same as the existing one. HMRC rejected it.

Decision:

At the hearing, the FTT asked HMRC to confirm that it had given a direction to terminate the use of the existing PESM. HMRC was unable to give such confirmation and simply pointed out that a previously agreed PESM is automatically revoked when the trader joins a group. However, in the absence of any legislative provision to that effect, the FTT considered that the appeal had been made on a 'false premise'. The existing PESM was still operative, pending the issue of a direction to terminate it by HMRC.

Comments – This is an example of how badly HMRC had mishandled the situation and come to the hearing utterly unprepared.

Dynamic People Ltd v HMRC TC 5003

Road fuel scale charge for cars used by sale reps

Summary – The First-tier Tribunal agreed with the taxpayer that the private use of the vehicles should be ignored

The taxpayer allowed its sales employees to use company cars for work purposes only. Until April 2012, the employees were based at the main office in Preston, and the cars were kept there. After that date, they were home-based so they kept the cars at their homes overnight. The employer paid all the running costs for the cars.

The company claimed input tax on all road fuel purchased for the vehicles and argued that no output tax was payable for the provision of fuel for private use because this was not permitted. HMRC argued that home-to-office trips would be classed as private after April 2012 and before this date there were occasions when the employees would take the vehicles home and therefore a fuel scale charge liability arose.

The taxpayer confirmed that, before April 2012, perhaps twice a year because of a late appointment and for safety reasons, the employees might take the vehicles home overnight. But this was incidental and should be ignored (s56(9) VATA 1994).

Decision:

The First-tier Tribunal agreed with the taxpayer that the private use of the vehicles should be ignored because they had not been 'allocated' to specific employees and the private use was 'merely incidental' (s 56(9)(b)).

The appeal was allowed.

Comments - Neil Warren, independent VAT consultant, said: 'It is rare for a case about road fuel scale charges to be heard in the courts. The legislation is clear on this subject but for some reason HMRC felt there was significant private use of the vehicles taking place,which was not the case in reality. The decision reaffirms the important principle that, if an employee or director is home-based, then home-to-company office journeys are classed as business rather than private trips.'

Broadsteady Ltd v HMRC TC4886

Did gym membership payment include an exempt supply of credit?

Summary – Output tax was due on all payments made in the second and subsequent years

In the first year of joining the gym as a 'results' member, an individual could make an advance payment of £593.45 or 12 individual monthly payments of £53.95. It was accepted that the instalment arrangement included an exempt credit charge of £53.95 (£4.50 a month).

At the end of the first year the member could continue to pay monthly instalments of £53.95, and had the right to cancel the arrangement by giving three months' notice to the gym. The directors considered that the second and subsequent years' payments continued to include an exempt credit charge of £4.50 in each monthly payment. HMRC disagreed, saying members were not given the option of making an annual payment in advance in the second and future years of membership, only in the first year. As a result, there could be no credit charge, even though the member's monthly membership fee was not reduced by £4.50.

The matter proceeded to the First-tier Tribunal.

Decision:

The tribunal agreed with HMRC that output tax was due on all payments made in the second and subsequent years. The judge said the contract did not provide for a 'results' member to pay by lump sum in the second and subsequent years. Therefore the gym was not giving credit for any sum in the second year. Further, there was no 'period over which credit is given or any disclosure of a charge for credit'. Without these factors there could be no exempt supply of credit.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, commented: 'The output tax liability in this type of situation depends on the wording of the contract between the supplier and the customer, and the reality of the supply in terms of what the customer is paying for. In this case, there could be no VAT-exempt credit in the second year because the member did not have the option of paying his subscription with an advance payment (and therefore reduced annual fee) as he did in his first year. The decision is consistent with earlier cases on this subject.'

Sports and Leisure Group Ltd v HMRC TC4836

HMRC's use of best judgment

Summary – HMRC had used their best judgement

The taxpayer traded as an off-licence and grocery business. During a VAT compliance visit in February 2013, officers asked him to retain till rolls for a later review. In an unannounced visit a few days later, the officers took away two till rolls for analysis and found that the 'no sale' button had been used on what they considered an 'excessive number of occasions'. They concluded that he was making several off-record sales when he entered customers' cash in his till but not recording them as positive sales in his accounts. HMRC raised an assessment for £101,550 for the periods 11/09 to 5/13. The taxpayer was unable to explain the excessive number of 'no sales'.

Decision:

The First-tier Tribunal was satisfied that he had been suppressing his sales and agreed with HMRC that the number of no sales recorded was much higher than could reasonably be expected. The tribunal concluded the HMRC officers had used their 'best judgment' (s73 VATA 1994) in assessing the VAT. The taxpayer's appeal was dismissed.

Comments – Taxpayers should be able to justify their takings and it was clear to HMRC that potentially the takings were not correctly stated – the decision follows logically therefrom.

S Laghmani v HMRC TC4863

Is a game with or without interaction with other players?

Summary - The Court of Appeal allowed the taxpayers' appeal from the UT by holding that exemption, rather than standard-rating, applied to fees paid by participants playing Spot the Ball (STB).

The issue was whether STB was a game of chance under the Gaming Act 1968 so that it was exempt from VAT under Group 4 Sch 9 VATA 1994.

The purpose of the game was to 'use your skill and judgment to decide from all the information contained in the picture, the spot where you think the centre of the ball is most likely to be and indicate the spot by making a cross'. HMRC contended that there was a requirement in law that a 'game' involved inter-player interaction; and, since a competitor simply had to send in his coupon, this was not a game.

Decision:

The Court of Appeal found that none of the three most important cases (which all related to bingo) — *Regional Pools, Adcock* and *Armstrong* — suggested that inter-player interaction was a requirement for there to be a game. In particular, *Adcock* and *Armstrong* clearly contemplated that there could be a game without the contestants being in communication with each other. Furthermore, there was no distinction in the Gaming Act 1968 between single-player and multi-player games.

Comments - In 2009, a claim was made that VAT should not have been charged, as it was an exempt game of chance, rather than a taxable game of skill, even though there was no interaction between the competitors. The taxpayers claimed repayment about £72m, being over-declared output tax (but net of over-claimed input tax). The significant amount of VAT at stake explains why the case has gone on for so long. The dispute concerned the law during the period from 1979 to 2006, so is not of general interest.

IFX Investment Company and Others v HMRC EWCA

Amendment of existing claim or new claim?

Summary – The UT dismissed the firm's appeal against the decision of the FTT that both its claim in November 2009 and its claim in January 2010 were stand-alone claims, rather than amendments of an earlier and in-time claim.

The issue was what amounted to an amendment of an existing claim for repayment of overpaid VAT under s80 VATA 1994. Grand Entertainments ran a bingo and social club. Following the successful appeal of the *Rank Group* in the Supreme Court in 2015, it had made a repayment claim relating to mechanised cash bingo gaming machines in March 2009. Two further letters had then been sent to HMRC extending the scope of the claims to main stage bingo (MSB) (bingo played in the traditional way) and the period of time covered.

Grand Entertainments claimed that these letters amended the March 2009 claim. HMRC considered that they amounted to new claims and were therefore out of time, on the basis that they had been made after 1 April 2009 and were barred by the three-year cap contained in s 80.

Decision:

The UT found that a conclusion that a later claim could always be regarded as an amendment to an earlier claim in respect of the same or similar supplies would significantly undermine the effectiveness and purpose of the s 80 limitation period. Furthermore, the test of whether a subsequent claim should be regarded as an amendment of an original claim would be satisfied only if the later claim arose out of the same subject matter as the original claim, without extension to facts and circumstances that fell outside the contemplation of the earlier claim. As the new demands concerned additional gaming machines and time periods, they could not constitute amendments to the original claim.

Comments - This was an easy appeal for the UT to dismiss. Presumably, the firm's decision to proceed was driven mainly by the significant amount at stake. If the firm had been dissatisfied with HMRC's view of the law in relation to MSB, the appropriate and prudent course for it to have taken (especially given the impending cut-off date for claims of 1 April 2009) would have been to claim for MSB and then appeal its rejection. The fact that the later claims were expressed as amending the original claim did not affect their true nature.

Grand Entertainments Company v HMRC UKUT

Philanthropic exemption

Summary - The FTT found that supplies of membership by a society for the promotion of classical music fell within the philanthropic exemption.

The society was a members' society and members paid annual subscriptions with various rights and benefits being associated with membership. One of the benefits was the right to priority booking, in advance of tickets going on open sale to the general public. The society appealed against HMRC's refusal of a repayment claim in relation to members' subscriptions.

Decision:

The first issue was whether the grant of membership was a supply within the scope of VAT. The FTT noted that the society was granting intangible contractual rights to persons who were prepared to guarantee the liabilities of the society and to pay the annual subscription. Members paid the subscription to receive corporate rights, such as the right to vote, as well as other benefits, such as membership of the Hallé Club and the Yearbook. The supply was therefore within the scope of VAT.

Secondly, the FTT found that there was a single supply of the rights and benefits arising from membership, as it was an indivisible economic supply that it would be artificial to split.

Finally, the FTT had to decide whether supplies by the society fell within the philanthropic exemption The FTT noted that 'philanthropy' had a wider meaning than the legal term 'charity'. The fact that a body was involved in an economic activity of making supplies to its members did not prevent it from being philanthropic. The issue was whether the society's aims of promoting the study, practice and knowledge of the art of music through concerts, educational programmes and community initiatives was philanthropic in nature. The FTT considered that a philanthropic organisation was an organisation which existed for the benefit of society or certain sections of society in a broad sense. The society was therefore philanthropic.

Comments - The FTT noted at para 128 that the great philanthropists of the 19th Century had focused on private initiatives for public good. Their philanthropy had not stopped at building decent housing and sanitation for workers but had extended to schools, universities, parks and gardens, libraries, public art galleries and museums. It is difficult to see why art and literature should be distinguished from music in this context.

Hallé Concerts Society v HMRC TC 5067

Option to tax validly exercised

Summary - The Upper Tribunal (UT) dismissed the appeal by Mr and Mrs Hills against the FTT decision that VAT was chargeable on the sale to them of a freehold commercial property.

The issue was whether the sale of a unit in a business park to Mr and Mrs Hills by the trustee of a self-invested pension plan (SIPP) was chargeable to VAT at the standard rate. On 6 August 2010, the trustee belatedly notified HMRC that it had opted to tax the property from 14 April 2004. The effective date was then amended and HMRC formally accepted the trustee's late notification with an effective date of 30 March 2004. The Hills contended that the option was invalid as the trustee should have sought prior permission from HMRC.

Decision:

The UT found that para 3(9) Sch 10 VATA 1994 only required prior permission of HMRC in respect of exempt supplies before the date on which the election had been intended to have effect; 30 March 2004. As the grant of the lease to the Hills' predecessor had taken place on 31 March 2004, no permission had been required. In any event, HMRC had written to the trustee dispensing with the requirement to seek prior permission under Sch 10 para 30. Para 30 was already in existence at the time of the purchase of the property by the Hills, so any argument based on the need for permission would have been subject to that provision.

Comments – The taxpayers lost on both points.

Mr and Mrs Hills v HMRC UKUT

VAT treatment of converted public house

Summary – The FTT found that the conversion was zero-rated.

The property traded as a public house until 2010 and comprised three floors, two of which were used for residential purposes as owner accommodation. The taxpayer converted the building vertically into four residential maisonettes. Two comprised half of the ground floor and half of the first. The other two were converted from the old residential accommodation and a new fourth floor. The taxpayer treated the sales of the two maisonettes that used the commercial floor as zero-rated (item 1(b) Sch 8 Group 5 VAT 1994). It was agreed that the other two maisonettes were exempt because they had not used any of the commercial floor.

HMRC disagreed that the maisonettes were zero-rated because they used space that has been previously used for residential purposes as well as the ground floor.

Decision:

The First-tier Tribunal considered note (9) of group 5, which specifies that zero-rating can apply to residential conversions that partly use residential and non-residential parts if they create an 'additional dwelling or dwellings'. HMRC argued that note (9) was irrelevant because of item 1(b), which states that only non-residential buildings or parts of buildings can be used. The tribunal said, if this were the case, note (9) would never have any purpose.

It concluded that 'the correct interpretation of item 1(b) must be one which sets it in the context of group 5 as a whole, which provides a role for note (9) and which meets the social purpose.' An interpretation of item 1(b) which left note (9) without any function could not be correct.

Therefore the purpose of note (9) was 'to exclude from item 1(b) any conversion of a mixed use building into dwellings unless additional dwellings … have been created as a result of the conversion of the non-residential part of the mixed use building'. The tribunal added: 'As the effect of converting the non-residential part of a building alone … into a dwelling would always be to create more dwellings than previously existed, we conclude that the draftsman must have contemplated the possibility that one or more new dwellings would be created from bringing together residential and non-residential parts of the mixed use building.'

The taxpayer's appeal was allowed.

Comments - Neil Warren, independent VAT consultant, commented: 'The issue of vertical residential conversions that partly use residential and non-residential parts of the previous building is now quite ridiculous. The score is 2-2 in terms of recent First-tier Tribunal cases. It must be time for HMRC to appeal this decision to the Upper Tribunal where a point of law will be binding in future or amend its guidance. It is important for taxpayer certainty that the issue is finally resolved, especially as large amounts of input tax are involved with many projects of this nature.'

Languard New Homes Ltd v HMRC TC4917

"Halifax" applied to a scheme for the recovery of input tax

Summary -The Court of Appeal decided that a scheme entered into to improve the university's recovery of input tax was abusive.

The university made exempt supplies of education, as well as a few taxable supplies, so that it was only able to recover a small proportion of input tax. It had implemented a scheme to enable it to recover VAT incurred in refurbishing two buildings. Under the scheme, the university had waived the exemption in relation to the buildings and granted a lease to a specially created trust, which had also opted to tax and granted a repair lease back to the university. The university had then contracted with a wholly owned subsidiary for the works to be subcontracted to an independent building company.

It was accepted that the second limb of the *Halifax* test (Case C-255/02) was satisfied: the essential aim of the transaction had been to obtain a tax advantage. The issue was whether it had resulted in a tax advantage contrary to the purpose of the relevant provisions.

Decision:

The court noted that the abusive tax advantage was the ability to deduct the whole of the input tax. This was different from *Weald Leasing*, where there had merely been a spreading of the payment of irrecoverable VAT over a period. Furthermore, the FTT had found as a fact that it had always been the intention of the university to collapse the leasehold structure. The court also agreed with the UT's finding that the tax advantage had been obtained by the interposition of actors and transactions which had no other purpose and should therefore be disregarded when redefining the transaction.

Comments – The decision is self-explanatory

The University of Huddersfield Higher Education Corporation v HMRC EWCA

VAT Payback and clawback adjustments (Lecture B960 – 14.50 minutes)

Background

A four year time period is relevant to adjusting errors on past VAT returns – but it is not relevant to every VAT situation that we deal with in practice. For example, a late VAT registration can be backdated by HMRC as far as 20 years and their power to collect tax that has been fraudulently evaded also extends to 20 years rather than four. However, a six year period applies in relation to the **payback and clawback regulations**.

The **payback** regulations apply (in basic terms) when an expense is intended to be used for exempt purposes (so input tax is not claimed) but a taxpayer's business plans change in the future and it becomes relevant to a taxable activity (so input tax can be claimed when the decision is made to change the nature of the activity).

The **clawback** rules deal with the opposite situation ie input tax is claimed based on intended taxable use but then the actual activity generates exempt income so the input tax is clawed back by HMRC on the VAT return that coincides with the change of plans. It is all about the first income generated by an activity.

The rules also apply when a mixed use outcome is evident ie a change of intention from generating wholly taxable or wholly exempt income to one that generates both taxable and exempt income (so the input tax becomes 'residual input tax' in the mysterious world of partial exemption) or vice versa.

Example 1

John is VAT registered as a sole trader and has built a new bungalow to sell (zero-rated – VATA1994. Sch 8, Group 5, Item 1). He claimed input tax on building materials and professional fees relevant to the project (but not construction services, including materials supplied by the builder as part of his work, because these are also zero-rated in relation to new dwellings). However, he instead decided to rent out the bungalow on a long-term basis rather than sell it ie the first income relates to an exempt rather than taxable supply. John must repay all of the input tax claimed within the last six years on the return that includes the date when he changed his mind.

1995 VAT Regulations, SI1995/2518, Regs. 108 to 110.

How things can go wrong

Here is a situation I dealt with recently:

- A business bought some land in April 2010 for £200,000 + VAT with a view to building four houses on the land and selling them to private individuals ie zero-rated sales.

- The owners correctly claimed input tax of £35,000 on the land purchase, which was relevant to the bad old days when we only had 17.5% VAT.

Note – the cost of the land was less than £250,000 so the capital goods scheme is a red herring where input tax is adjusted over a ten-year period.

However, the business did not develop the land because of a lack of funds and lack of confidence in the property market so the land was untouched and unused for five years. But the good news is that the owners got some money back in March 2015 when they sold it to a private individual for £110,000 (but still a £90,000 loss).

The bad news, however, is that the adviser gave his client some VAT advice, which was partly incorrect:

- He advised the client that because there was no option to tax election in place on the land, then the proceeds of £110,000 would not be subject to output tax. This was correct advice - the land sale is exempt from VAT under VATA1994, Sch 9, Group 1 in the absence of an election by the seller

- He also advised the client that because the input tax on the land purchase was claimed more than four years ago, it was out of time under the four year adjustment rule. This advice is not correct. The purchase of the land is captured by the payback and clawback regulations and the six year window that applies for these rules. So the client should have reduced his input tax by £35,000 on the VAT return that coincided with his decision to sell the land.

The point I had to explain to the adviser was that there had been no 'error' when the initial input tax claim was made on the land purchase in 2010. The business owner had an intention at that time to make taxable supplies in connection with the land, so had a right of deduction. It was only when he changed his mind in March 2015 that the goalposts moved.

To conclude this story, it would have been a better result for the business owner to have made an option to tax election before he sold the land, either charging £110,000 plus VAT or £110,000 including VAT on the sale. This would have protected his input tax claim of £35,000 back in 2010 because the end result of the deal is still a taxable sale – so an output tax bill of either £22,000 or £18,333 is much better than an input tax loss of £35,000. In an ideal world, an option to tax election and a land sale to a business that could claim input tax would have been the perfect 'win: win' outcome.

Option to tax election and six year rule

Here is another example of when a six year adjustment applies in the VAT world:

- A business bought a piece of land in April 2004 for £200,000 + VAT – and it made an option to tax election on the land – which it sold for £230,000 + VAT in April 2005.

- The same business bought back the same piece of land again in April 2010 for £150,000 + VAT – but did not make any option to tax election with HMRC. It claimed input tax on its June 2010 VAT return because it intended to build houses on the land and sell them ie zero-rated sales of new residential property.

- No building work was carried out and the land was sold for £200,000 (no VAT) in April 2015 to a property company that intended to build the houses instead.

The adviser acting for the landowner gave two pieces of incorrect advice:

- He said that once the land was sold in April 2005, the option to tax election made in April 2004 became null and void – so the April 2015 land sale was exempt from VAT.

- He then told the client that there was no issue with the £26,250 of input tax claimed in April 2010 on the second purchase of the land because the time period was more than four years before the land sale in April 2015 ie it was out of time with the error adjustment period.

The reason that the first advice is incorrect is because once a business makes an option to tax election with HMRC, it remains in place for at least 20 years before it can be reversed and applies to all supplies made in connection with the land or building, excluding the usual overrides such as rental or sale proceeds from residential accommodation. Now here is the key piece of legislation: if a business has had no interest in an opted building or piece of land for at least six years, then the option is automatically revoked. But that does not apply here because the period when the business had no interest in the land was only five years ie between April 2005 and April 2010. So the April 2004 election was still valid at the time of the second land sale in April 2015, meaning the proceeds of £200,000 were standard rated.

The second piece of advice is incorrect because, as explained earlier, the relevant period for the payback and clawback regulations is six years and not four. So the input tax claim of £26,250 made in April 2010 is not time barred when the land sale was made five years later. But there is good news here which might save the day and avoid the need for the client to pay back £26,250 of input tax on his June 2015 VAT return (assuming calendar quarter VAT periods):

- The land sale for £200,000 in April 2015 should have been standard rated because of the election made in April 2004.

- We have made contact with the property developer that bought the land and he is prepared to accept a belated VAT charge of £40,000 because he can claim input tax on his own return because of the taxable intentions of his own project. Our client issues a VAT only invoice for this amount.

- The end result is that our client has no loss of input tax on the April 2010 land purchase because his intended taxable supplies of selling zero-rated houses have still ended up with an actual taxable supply, albeit one that is different from the original intention. The clawback rule only applies when an intended taxable sale becomes an actual exempt sale.

Contributed by Neil Warren