Tolley®CPD

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Personal Tax

Lifetime ISA – Can we use these in OMB planning? (Lecture P961 – 10.16 minutes)

From 6 April 2017 any adult under 40 will be able to open a new Lifetime ISA and contribute up to £4,000 each year and will receive a 25% bonus from the government at the end of the year. The savings may be kept in cash or investments and will be allowed to grow tax free within the Lifetime ISA

Savers will be able to contribute to one Lifetime ISA in each tax year, as well as a cash ISA, a stocks and shares ISA, and an Innovative Finance ISA, within the new overall ISA limit of £20,000. A Lifetime ISA can be funded by transfers from other ISAs in accordance with normal rules.

Contributions can continue to be made with the bonus paid up to the age of 50.

Funds, including the Government bonus, can be used to buy a first home at any time from 12 months after opening the account, and can be withdrawn from age 60 for use in retirement. The limit for property purchased using Lifetime ISA funds will be set at £450,000 and will apply nationally.

Savers can continue to open a Help to Buy ISA until November 2019 and can also choose to open a Lifetime ISA, but will only be able to use the Government bonus from one of their accounts to buy their first home. During the 2017/18 tax year, those who already have a Help to Buy ISA will be able to transfer the savings they have built up into the Lifetime ISA and still save an additional £4,000.

<u>How can we use them in an OMB?</u>

In 2016/17 Dean gifted his 18 year old son shares in his trading company. Max now receives a quarterly dividend of £1,250 that is tax free in his hands. The dividend continues for three years and helps Max through university.

After leaving university the company continues to pay the £5,000 annual dividend. Dean and Max have agreed that £4,000 of the annual dividend will be paid direct into Max's lifetime ISA.

If the dividend was reduced to £4,000 it would equate to £5,000 tax free extraction from the company. The company's pre-tax position of £5,000 (to cover a £4,000 dividend) equals the uplifted annual LISA contribution. Hence the tax free extraction.

The dividend is however left at £5,000 as Dean is a generous fellow! He is happy that the company utilises £6,250 of pre-tax profits to pay Max's £5,000 dividend. At the end of each year Max has £5,000 in his LISA and another £1,000 to spend on an annual golf trip with his father! This equates to a £250 tax bill on corporate profits of £6,250 – an effective rate of 4% on extraction.

LISA's could also be used to help children with deposits on their first home or to provide pension provisions for spouses on low or no income.

Liability of employee to car benefit (Lecture P962 – 8.23 minutes)

Summary – The FTT found that an employee was liable to tax on a car provided by her employer.

The taxpayer had been employed on a fixed-term contract. She was entitled to a car allowance which could be paid in cash or as a car. She opted for the latter. The car was worth less than the allowance, so the balance was paid in cash with her monthly salary.

In her tax return, car benefit was included according to the amount shown on the form P11D. The taxpayer said, because the employer had paid only the balance of the total allowance, she had, in effect, paid for the car lease payments and was entitled to deduct them. She also claimed mileage allowance.

Decision:

The First-tier Tribunal agreed with HMRC that the taxpayer had not contributed from her own resources towards the car. The car allowance had been a way of paying her cash or a payment in kind. Both were taxable: the first as a cash payment through PAYE and the second as a benefit in kind.

Further, the car benefit was chargeable under the benefits legislation in s114 ITEPA 2003. The car was made available by reason of the taxpayer's employment; no property had passed to her under the leasing arrangement and there was no prohibition on private use.

Further, she was not entitled to mileage allowance relief under s232 because the car was a company vehicle.

The taxpayer's appeal was dismissed.

Comments - The facts in this case differ from *Apollo Fuels Ltd* as the appellant did not have a proprietary interest in the car. She did not contribute from her own resources anything towards the acquisition of the car. The car allowance was a way of either paying her cash or giving her a payment in kind, i.e., the use of a car without payment. The so-called ‘trade up’ or ‘trade down’ payment was not relevant. As the FTT pointed out if it was relevant an employee would always opt for the car, and not the cash.

N Fowler v HMRC TC5095

Footballer transfer fees (Lecture P962 – 8.23 minutes)

Summary - The First-tier Tribunal held that payments made by a Premier League football club to two of its players on termination of their employment contracts did not derive ‘from’ their employment and therefore were not subject to National Insurance contributions (NICs), and were only subject to income tax above the £30,000 threshold

The appellant was the parent company of the well-known football club. In 2011, Tottenham had paid two of its players, Peter Crouch and Wilson Palacios, for their agreement to leave Tottenham to join Stoke City.

The issue was whether, as HMRC contended, the payments were earnings fully subject to income tax and NICs or compensation for early termination and therefore not 'from' the players' employment.

Decision:

The FTT pointed out that the fact that the parties might have had substantial reasons not connected with the players' employments for making or receiving the payments (for example, Tottenham's wish to secure a transfer fee) was not sufficient to prevent the payments being 'from' employment, provided that there was a 'sufficiently substantial' employment-related reason for making the payments.

There were provisions that would have entitled Tottenham to terminate the players' contracts early if particular circumstances had arisen. However, none of these early termination provisions were engaged, so neither the players nor Tottenham had any operative right of termination. Tottenham had therefore made the payments in return for the surrender of the players' rights under their employment contracts.

As the contracts were not terminated following a breach of contract, the termination was by mutual agreement (although both the players and Tottenham had been under pressure to reach an agreement). Additionally, both the FIFA rules and the employment contracts permitted the parties to terminate the contracts early by mutual agreement. However, payments made following such a mutual agreement were not within the scope of the principle in *EMI Group Electronics*, as the contracts had not specifically provided for the payments. The payments under the mutual agreement were therefore not 'from' employment.

Comments - The FTT held that as the contracts in this case were not terminated following a breach of contract, the termination was by mutual agreement. However, the payments made following such a mutual agreement were not within the scope of the principle in *EMI Group Electronics*, as the contracts had not specifically provided for the payments. It followed that applying the principle in *Henley v Murray* the payments did not derive 'from' the Players' employments.

At least Tottenham won something in 2016!

Tottenham Hotspur v HMRC v HMRC TC 5143

Partner's return inconsistent with partnerships' return (Lecture P962 – 8.23 minutes)

Summary - The FTT decided that the personal tax return of a partner does not have to be consistent with the partnership tax return if the partner disagrees with it.

The appellants had all been members of a limited liability partnership accountancy firm until the business of BTG had been acquired by accountants, Smith & Williamson LLP, so that each appellant had ceased to be a member of BTG and had become a member either of Smith & Williamson or of another firm of accountants.

The accounts of BTG, which had been audited by Deloitte as GAAP compliant, had showed a loss, but the partnership return had included a profit as a result of an 'add back' by designated members. However, the appellants considered that there had been no legal basis for the add back and had filed their personal returns on that basis. HMRC considered that their returns had understated respective shares of BTG's profit.

The issue was therefore whether partners are entitled to declare different profit share figures on their personal tax returns to those declared on the partnership tax return, where they believe that the partnership's return is incorrect.

Decision:

The FTT observed that the statutory provisions 'do not slot easily into place' and do not appear to deal with the case where a partnership and individual partner disagree.

The FTT pointed out that under s25 ITTOIA 2005 profits of a trade must comply with the CA 2006 and be GAAP compliant. As Deloitte had confirmed that this was the case, the 'correct' figure from which to establish the right amount of tax was as recorded in each appellant's return.

Comments - This case confirms that a partner is not obliged to include the figure of the share of the partnership profit allocated to him/her as stated in the partnership statement on his/her return. Consequently failure to do so therefore does not amount to non-compliance with the statutory requirements (per s8 TMA 1970).

R King and others v HMRC TC5163

Capital Taxes

Corrections and amendments to the IHT account (Lecture P965 – 16.31 minutes)

This guidance note from Tolley Guidance explains how to deal with changes to the taxable values in the original inheritance tax account.

Why do amendments arise?

When the IHT account is first submitted to HMRC, it is based on information available at an early stage of the administration. Before probate is granted the PRs have not been able to sell any assets, nor have they paid any outstanding bills. Valuations at that stage may simply be estimates or calculations that turn out to be incorrect. In addition, some assets or liabilities do not come to light until the process of administration reveals loose ends that need to be tied up.

Corrections to the IHT account may be generated by the taxpayer as a result of information which has become available whilst collecting in the estate. They may also be required following negotiations with HMRC or the District Valuer. Unless a non-cash asset is sold at arm's length close to the date of death, any market value assigned to it is purely a matter of opinion on which differences may arise.

Typical corrections

To an extent, the number and type of amendments to be reported will depend on how thoroughly the initial valuation of the estate was conducted, but this in turn depends on how complex it is, the nature of the assets and liabilities and how well the PRs knew the deceased.

The following lists are not exhaustive but provide a range of examples of the type of corrections that can be expected:

Changes to asset values and assets previously omitted

- **Bank accounts**

  Provided the date of death value has been supplied by the bank, there should be no change to the valuation of bank accounts already declared. Banks do sometimes forget to give a figure for interest accrued to date of death, but while interest rates are low, the omission is rarely significant.

  It is more common to find, during the course of administration, that a bank account has been overlooked in the initial summary of estate assets, or that a joint account has been incorrectly valued with regard to the deceased's beneficial share. Conversely, a bank account in the deceased's name may turn out to be an account that he held as trustee for another.

- **Share portfolio valuations**

  Where stockbrokers or investment managers hold stocks and shares on behalf of the deceased, they will provide a reliable probate valuation, together with dividends declared.

However, they do sometimes forget to provide details of the cash held on account, particularly the income account for some reason. Overlooked cash deposits with brokers can require fairly significant adjustments to the IHT account.

Where the deceased held shares in certificated form, shares previously valued may turn out to be obsolete or duplicated. Sometimes ownership of certain shareholdings is not discovered until the associated dividend appears in the deceased's bank account.

- **Antiques and collectables**

  The valuation of chattels is notoriously imprecise. Where the value is clearly material, an auctioneer will have been engaged to provide a professional valuation. The price achieved at a subsequent sale may be quite different from the original valuation. A practical difficulty with a large number of items is matching the items on the original valuation to items on the sales list because they are often grouped and described differently even by the same auction house, and some items will be left unsold. A degree of analysis is required to establish whether the original taxable value should be amended.

- **Property**

  HMRC will refer to the District Valuer the declared value of land and buildings included in the IHT account. If the District Valuer does not agree with the value declared, negotiation will ensue and may result in a change to the taxable value. Once a new value is agreed, HMRC will issue a calculation for the revised tax liability.

  The agreed value of property may be altered when new information is discovered about circumstances which existed at the date of death. For example, a property may be valued without knowledge of structural defects that only become known when an intending purchaser commissions a survey.

  Interests in jointly owned properties, even properties in sole ownership, parcels of land, leases or other rights such as fishing rights may emerge once the administration gets under way.

- **Income due**

  Income due to the deceased at date of death is often estimated on the IHT account and the actual amount is not known until it is received. Rental income and trust income due to date of death will have to be calculated, and in some cases the PRs will have to wait until rental or trust accounts have been prepared by other agents. Where the deceased had a number of pensions, it may be some time before all the final payments are ascertained.

- **Interest in another estate**

  Where the deceased had been left a specific bequest or a share of the residue of another unadministered deceased estate, it is quite likely that the value of the bequest can only be estimated in the IHT account.

In the case of a share of residue, the value of the bequest cannot be determined until the value of the first deceased's estate is determined and that estate in its turn may be subject to amendment. Aside from date of death values, the capital value of the bequest will be affected by expenses incurred during the course of administration of the first deceased's estate.

Liabilities

- **Tax**

  The deceased's income tax or capital gains tax liability to date of death is likely to have been estimated for the purpose of the IHT account, but not finalised. Chargeable gains on life insurance policies may not become evident until after probate has been granted and can result in a high income tax liability in the year of death.

- **Funeral expenses**

  The funeral account provided by the undertaker will doubtless be included in the initial IHT account, but what is often overlooked or unknown at the time, are the costs of the funeral reception, headstone or memorial.

- **Claims against the estate**

  Any type of claim against the deceased, and subsequently his estate would be suspended until probate is granted and may not be quantified until much later.

- **Personal and domestic expenses**

  Numerous expenses may come to light during the course of the administration such as those relating to utility bills, nursing home and medical fees, tradesmen and domestic services.

Reliefs and exemptions

Changes to exemptions may arise as a result of establishing the charitable status of a beneficiary, or sometimes claims for exemption are simply overlooked initially. A closer review of the deceased's business interests may alter the claim for APR or BPR.

Where a deed of variation is executed after probate is granted, the revised distribution may generate a change in the tax liability, such as an increase or decrease in the spouse exemption.

Keeping track

It is important to keep a running tally of the corrections and amendments required as they arise. The most useful format is one that will feed in to HMRC's formal corrective account, Form C4. It would comprise a schedule showing all the assets and liabilities declared on the original IHT400, increases and decreases in those values, additional and deleted items, and the final amended values. You will be able to keep track of the overall tax difference that will indicate whether it is advisable to make an early payment on account.

All of the amendments will be reflected in the final Estate Accounts either by changing the values presented in the Estate Account at death or by including a separate schedule showing how original values were amended. It is a matter of choice, depending partly on complexity and the extent of the amendments, whether you include the detail of how the IHT account has been changed. Where you are administering the estate on behalf of PRs who are not closely involved, it is advisable to show them how the figures that they originally authorised have been amended. See the Format for estate accounts guidance note.

Corrective account - Form C4 and informal reporting

HMRC provides Form C4, known as the corrective account, for reporting amendments to the original IHT account. It is designed to cover a number of amendments and in more straightforward cases an informal report is acceptable. See below. There are four main sections to the official form which cover:

- increases in asset values
- decreases in liabilities, exemptions and reliefs

These two categories are added together to give total increases in the value of the estate.

- decreases in asset values
- increases in liabilities exemptions and reliefs

These two categories combined make up the total decrease in value of the estate.

The overall net adjustment is then added or subtracted from the value of the estate as shown on the IHT400, or the last official calculation, to arrive at the current taxable value. Professional advisers are then expected to calculate the tax payable or repayable as a result of the amendment.

The corrective account Form C4 should be signed by all accountable persons, that is the personal representatives who signed the original IHT400. It cannot be signed by an agent. However, where amendments are reported outside of the Form C4, the agent, or just one of the PRs can provide details, and a declaration by all accountable persons is not required.

Therefore the distinctive features of a corrective account on Form C4 as opposed to an informal report are that:

- it covers a number of amendments,
- it reconciles to the latest agreed calculation of inheritance tax, and
- it is authorised by those who are responsible for paying the tax.

Consequently, HMRC insists on a Form C4 where they need to rely on the declaration of the PRs, such as where estimates have been used or adjusted, or where there is any doubt about the amount of tax payable or repayable. They will also require a Form C4 where there are a large number of amendments or they are complicated. IHTM10702

It is a matter of judgment on both sides whether an informal account will suffice. The agent can inform HMRC by letter where there are one or two significant changes to the value of the estate. If there are a large number of low value corrections, again an agent's letter should be accepted particularly if the tax is increased rather than decreased. The advantage of reporting by letter is that the practitioner does not have to obtain the signature of all PRs on the form, which can sometimes be a time-consuming process. In cases of borderline complexity where it will take time to get all PRs to sign, it is worth phoning, if you have the name of a direct contact, to ask whether the Form C4 will be required.

When to report amendments

Strictly, any corrections to the IHT account should be reported within six months of being discovered but HMRC has acknowledged that it is more efficient for both sides to save up amendments and report them in one go if possible. In certain circumstances, they waive the six month rule and allow all amendments to be reported together on one corrective account when: IHTA 1984, s 217

- all the final amendments are known, or
- within 18 months of the date of death

Whichever is earlier.

After 18 months, any additional amendments must be reported within the six month time frame.

In any case, amendments must still be reported within six months if they fall within any of the following criteria:

- HMRC has advised that they are starting a compliance check. (In this case, amendments should be reported as soon as identified)
- the estate includes a qualifying interest in possession or a gift with reservation. This is because any amendment to the deceased's free estate will affect the tax liability of the trustees or donees
- the change in value of the estate is greater than £50,000 before exemptions or reliefs are deducted
- the amendments relate to changes in the value of land and buildings or unlisted shares

In addition if the change in taxable value relates to a claim for loss on sale of land or shares, different timescales apply and these should be reported separately. See below. And where assets have been sold on which tax is being paid by instalments, HMRC should be advised of the sale immediately.

Once a corrective account has been filed, HMRC will issue a revised calculation of the tax for the titles affected. Any further amendments should then be declared on a new corrective account (either formally on Form C4 or informally). The amendments already assessed should not be included again. Where, for example, the valuation of the same asset has changed more than once, the latest confirmed value should be shown in the column 'Previous value (as given in the IHT400)', so that the amendment builds on the latest position. Interest will be charged from the original due date where amendments result in additional tax. When saving up amendments, a payment on account can be made in respect of the known amendments to avoid interest accruing.

Difference between corrected values and losses or gains

It is necessary to distinguish between a correction to the date of death value and a loss or gain that arises after death. Inheritance tax is charged on the value of the estate at date of death. As explained above, amendments to the reported value may occur because of incomplete knowledge at the time the valuation was made. When additional information amends the valuation, the inheritance tax charge is correspondingly adjusted.

This is different from the situation where the value of an asset or liability has changed since the date of death. It is possible for asset values to change as a result of circumstances that arise after death but this does not invalidate the date of death value. The difference is rather a loss or gain that is reported under capital gains tax rules when the asset is sold. It does not affect inheritance tax.

Where an asset is sold or a liability settled some time after the death, it is not always clear whether or to what extent a change in value indicates that the original value was unreliable. It may be a matter for negotiation bearing in mind the principles outlined.

Claim for loss on sale of land or shares

The inheritance tax legislation does contain two special provisions which allow losses that arise after death to be related back to the date of death so that the lower value achieved on sale is recognised in the value on which inheritance tax is charged:

- where quoted investments are sold at a loss within 12 months of death, the sale price may be substituted for the market value at date of death. See the Sale of shares from deceased estate guidance note for the detailed rules and how to claim (IHTA 1984, s 179)
- where an interest in land is sold at a loss within four years of death, the sale price may be substituted for the agreed value at date of death. See the Sale of land from deceased estate guidance note (IHTA 1984, s 191)

The conditions for the claims are restrictive and they only apply where assets are actually sold by the PRs within the time limits. If a claim is to be made, it does not form part of the overall corrective account on Form C4. A claim for loss on shares is made on Form IHT35 and a claim for loss on land is made on Form IHT38. Both types of claim must be made formally on the prescribed forms and signed by the persons responsible for paying the tax.

Produced by Tolley Guidance

BATR due on land sale proceeds

Summary – The First-tier Tribunal held that land maintained by the owner (and occasionally used for grazing) but subject to a grazing agreement with another farmer for part of the year was a business asset because it was 'wholly or mainly occupied for the purposes of husbandry

The taxpayer inherited land from his grandmother in 1998. He sold it in July 2007. During the period he owned the land, it was farmed under conacre arrangements.

He claimed business asset taper relief to reduce the gain on the sale but HMRC refused, saying the taxpayer had not occupied the land for the purpose of husbandry; rather it had been let to another farmer (C).

The taxpayer appealed.

Decision:

The First-tier Tribunal said the taxpayer had occupied the land. The tribunal was 'strongly influenced by the traditional understanding' of conacre arrangements that the grantor of the licence remained in occupation. Further, C did not occupy the land for part of the year.

On husbandry, the taxpayer had undertaken relevant acts. He kept the land to a good standard, ensuring it was fertilised when necessary; he also carried out maintenance and repairs. Therefore the taxpayer's occupation of the land was wholly or mainly for the purposes of husbandry. As such, the land was farm land, he was farming it, and therefore business asset taper relief was due for the whole period of ownership.

The taxpayer's appeal was allowed.

Comments - Although taper relief ceased to be available from 6 April 2008, the case remains relevant for the purposes of determining whether a trade of farming is being undertaken. The Tribunal also considered previous cases (McCall (personal representative of McClean, deceased) v R & C Commrs in 2009 – land subject to seasonal grazing arrangements excluded from business property relief as consisting wholly or mainly of making or holding investments and Evelyn in 2011 – business asset taper relief not available because land farmed by the tenant) but concluded that each case must be determined on its particular facts.

J C Allen v HMRC TC5100

Sub-sale relief and alternative finance relief

Summary - The Court of Appeal upheld the taxpayer's appeal and dismissed HMRC's cross-appeal. The sub-sale falling within s45(3) FA 2003 was to be treated as a direct acquisition by the financial institution from the third party vendor for SDLT purposes. The financial institution was therefore liable for SDLT on completion of the secondary contract under s43(3), and was not entitled to claim s71A relief.

The issue was the SDLT payable on the purchase of the Chelsea Barracks from the Minister of Defence (MoD) by Project Blue (PBL), using an Ijara lease, which is a form of Sharia compliant financing (as opposed to an interest-bearing loan). The sale comprised the following steps:

1. MoD contracted to sell the land to PBL for £959m;
2. PBL contracted to sell the land to a Qatari bank (MAR). Under leaseback arrangements, PBL was to pay MAR rent (representing installments of the purchase price); and
3. PBL and MAR granted each other put and call options over the land.

The UT had found that PBL was liable to SDLT in the sum of £38m based on a consideration of £959m under s 75A. PBL contended that the party liable was MAR.

Under FA 2003 s 45 (before its 2008 amendments), PBL was not liable to SDLT, as the completion of the contract between the MoD and PBL was 'disregarded' under 'sub-sale relief'. Furthermore, under s71A FA 2003, no SDLT was payable on the transfer from the MoD to MAR under the second contract. This was because s 71A ensured that no SDLT was triggered by an Ijara lease transaction. Consequently, both the transfer to MAR and the leaseback by MAR were exempt alternative finance transactions. Finally, s 75A applied to a series of transactions between a vendor 'V' and a purchaser 'P', where the total SDLT payable was less than would have been payable on a direct sale by V to P.

Decision:

The court observed that the purpose of s 71A was to limit SDLT to a single charge on the acquisition of the property from the third party vendor, whether by the financial institution or its customer. It would therefore be 'strange' for Parliament to have intended that both the acquisition of the property by the customer and its later acquisition by the financial institution should be SDLT free under sub-sale relief. The court therefore thought that the 'much more obvious construction of s 71A' was that cases falling within s 45(3) were intended to be treated as direct acquisitions by the financial institution from the third party vendor, which triggered SDLT so that MAR was liable.

As to s 75A, the court stressed that there was no reference in the provision to the purpose of the transaction being tax avoidance. Under s 75A, MAR was 'P' and must be treated as such. However, this was only relevant if the court was wrong in relation to s 71A.

Comments - One can expect HMRC to seek to take this to the Supreme Court. Whilst the Court of Appeal took a decisive view, without the relative agonising shown by the earlier Tribunals, it arguably remains slightly odd (even before getting to the operation of s75A) to end up looking at the matter as a direct purchase of property *from the MoD* for a consideration of £1.25bn.

Project Blue Ltd (formerly Project Blue (Guernsey) Ltd) v Revenue and Customs Commissioners [2016] BTC 22

Take care with percentages (Lecture P963 – 16.44 minutes)

There has been an interesting decision involving entrepreneurs' relief and shares in the First-Tier Tribunal case of *Castledine v HMRC (2016)*.

It is well known that, in order to qualify for relief, Ss169I and 169S TCGA 1992 require an individual to:

- have held at least 5% of the company's ordinary share capital and voting rights throughout a period of 12 months ended with the share disposal; and
- have been an officer or employee of that company throughout the same period.

The definition of 'ordinary share capital' is taken from S989 ITA 2007 which says:

> 'Ordinary share capital, in relation to a company, means all the company's issued share capital (however described), 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.'

The taxpayer (C) had been the commercial director of Park Resorts Ltd until his retirement in September 2007, six months after the company had been acquired by Dome Holdings Ltd. In C's absence, the business did not prosper and so he was called back in December 2008 to assist in a financial rescue that turned out to be successful. The rescue included a restructuring of Dome Holdings Ltd's capital, under which C was allocated 5% of the company's ordinary shares.

In 2011/12, C disposed of loan notes in Dome Holdings Ltd (acquired at the time of the takeover) that were worth £600,000 and, in 2012/13, he disposed of a further tranche worth £500,000. Both of these transactions gave rise to chargeable gains, against which C claimed entrepreneurs' relief. He still held his ordinary shares.

Unfortunately, there was a problem. Dome Holdings Ltd had recently issued additional deferred shares which had no rights to a dividend and no voting rights. Their sole value was the right to be redeemed at par on a capital realisation after £1,000,000 had been distributed in respect of each of a particular class of ordinary share. Given that there were more than 2,000,000 shares in the relevant class, this meant that, in reality, the deferred shares were worthless.

Although C held exactly 5% of the company's ordinary share capital, his percentage interest in Dome Holdings Ltd dropped to 4.99% if the deferred shares were taken into account. In other words, if the deferred shares formed part of the company's ordinary share capital, Dome Holdings Ltd was not a 'personal company' in relation to C.

The deferred shares had been created on legal advice as a mechanism for removing ordinary shares awarded to members of the senior management team of Dome Holdings Ltd if and when they left the company's employment.

The First-Tier Tribunal agreed with HMRC that the definition of 'ordinary share capital' was clear. This definition has been part of the tax code since 1938 and there was no doubt that – worthless or not – the deferred shares fell within the wording.

C's barrister did not feel that this conclusion fitted very well with the stamp duty case of *Collector of Stamp Revenue v Arrowtown Assets Ltd (2003)*. In that case, the company had issued deferred shares for the purpose of bolstering its ordinary share capital in order to enable it to satisfy the tests for stamp duty group relief. It was decided that the shares were issued simply for the purpose of claiming the stamp duty relief and so should be disregarded. The argument in the present case was that the deferred shares should also be disregarded. They were no more commercial than the shares in *Arrowtown*. Unfortunately for C, this line did not find favour with the First-Tier Tribunal. Nevertheless it does not seem right that the issue of absolutely worthless deferred shares was ignored in *Arrowtown*, but in the *Castledine* case they were not ignored. Having said that, one possible distinction is that, in *Castledine*, the shares were issued for a genuine commercial purpose, whereas they had no commercial rationale in *Arrowtown*.

It goes without saying that tax advisers need to keep a careful eye on their clients' percentage shareholdings, particularly where there are unexercised share options which, if exercised, could dilute a holding below 5%.

Contributed by Robert Jamieson

Higher rates of SDLT on additional residential properties (Lecture P964 – 27.00 minutes)

<u>Introduction</u>

Cl 117 FB 2016 introduces new higher rates of SDLT for purchases of residential properties made by:

(i) individuals who already own another dwelling (and are not replacing a main residence); and

(ii) any person who is not an individual.

<u>The new higher SDLT rates</u>

The higher rates are set at three percentage points above the normal SDLT rates and apply to residential properties purchased in England, Wales and Northern Ireland on or after 1 April 2016.

Such acquisitions will typically be of buy-to-let properties and second homes. Purchases of caravans, mobile homes and houseboats are not affected nor are properties costing less than £40,000 (nowadays there are unlikely to be too many of these!).

The table of higher SDLT rates is:

Purchase price	Rate paid on part of price falling within each band
Up to £125,000	3%
Over £125,000 and up to £250,000	5%
Over £250,000 and up to £925,000	8%
Over £925,000 and up to £1,500,000	13%
Over £1,500,000	15%

It should be emphasised that the 3% charge will apply to the entire value of the property (up to £125,000) where the consideration is £40,000 or more. Thus a second home purchased for £250,000 will attract a charge of £10,000, made up as follows:

	£
0 – 125,000 = 125,000 @ 3%	3,750
125,000 – 250,000 = 125,000 @ 5%	6,250
	£10,000

Such a property, if purchased before 1 April 2016, would only have had an SDLT cost of £2,500.

The higher rates will not apply if, at the end of the day on which the transaction is completed, an individual owns only one property, irrespective of the intended use of that property.

Illustration 1

On 1 May 2016, Ian bought his first house. Because he only owns a single property, he will not have to pay the higher rates of SDLT. This is the case, regardless of whether Ian intends to occupy the property as his main residence or rent it out.

On the same day, Ian's friend, Ken, who lives in rented accommodation, sells the only residential property that he owns (a buy-to-let) and purchases another buy-to-let. Because Ken only owns one property at the end of the day on which he completes, he will also not be liable for the higher SDLT rates.

Replacing a main residence

If, at the end of the day on which the purchase transaction is completed, an individual owns two (or more) houses or flats, the purchaser's liability for the higher rates of SDLT depends on whether or not he is replacing a main residence. Where the purchaser has sold a previous main residence within the last three years and the current transaction is the purchase of a new main residence, the individual will be considered to be replacing a main residence. As a result, the higher rates of SDLT will not be in point.

Illustration 2

Alexander owns a main residence and a holiday home. He sells the main residence and buys a new one. Although Alexander has two properties at the end of the day on which he completes the purchase, he is replacing his main residence and so the higher SDLT rates will not apply.

Where the individual purchases a new main residence *before* disposing of his previous one, the higher rates apply. However, there will be a refund of what turns out to be the overpaid SDLT for those who sell the old main residence within the three years following the acquisition of the new one. In other words, the purchase will cease to be what FB 2016 calls a 'higher rates transaction'.

Transitional rule

As mentioned above, the higher rates of SDLT only apply to purchases of additional residential property which complete on or after 1 April 2016. However, if contracts were exchanged on or before 25 November 2015 (the date of the Autumn Statement) but completion did not take place until after 31 March 2016, the higher SDLT rates will not, as a transitional rule, be payable.

Married couples and civil partners

The Government treat married couples (and civil partners) who live together as a single unit. This is consistent with other areas of the tax system such as CGT private residence relief where married couples are entitled to relief on one main residence between the two of them. Thus:

(i) married couples may own one main residence between them at any one time for the purposes of the higher SDLT rates; and

(ii) property owned by either party (and any minor children) will be relevant when determining if an additional property is being purchased or not.

Married couples are treated as living together unless they are separated under a court order or by a formal deed of separation executed under seal.

Illustration 3

Robin and Linda are a married couple who own two residential properties jointly. Although they spend time in both, only one of the properties is their main residence. If they sell this property and purchase a new main residence, they will not be liable to pay the higher SDLT rates given that, at the end of the day when they complete, they will simply be replacing their main residence. However, if they sell the property that is not their main residence (ie. their second home) and purchase another second home, they will have to pay the higher rates of SDLT.

Illustration 4

Godfrey and Sally are married. Godfrey owns a home which he purchased on his own before they were married where they now live as their main residence. Sally then buys a property to be rented out. At the end of the day when the transaction is completed, the couple own more than one residential property. Since they are not replacing a main residence, the higher SDLT rates apply.

Joint purchasers

There are many scenarios when two (or more) people may own or purchase a property jointly (eg. as brother and sister). If, at the end of the day on which they complete, any of the joint purchasers has two or more residential properties and is not replacing a main residence, the higher SDLT rates apply to the entire consideration for the transaction. However, given that the purchased property may be a first property for one of the owners, is this really the fairest outcome?

Parents and children

Where parents have the resources to do so, they will often want to help their children to make a start on the property ladder. Whether the higher rates of SDLT apply will depend on the structure of the transaction and who owns the property purchased.

Illustration 5

Patrick and Carole are a married couple who own their main residence. They decide to purchase a flat for their daughter to live in. At the end of the day on which the transaction is completed, Patrick and Carole own more than one residential property and are not replacing their main residence. Therefore, the higher rates of SDLT apply. In order to avoid this problem, the parents can agree to act as guarantor on the daughter's mortgage or lend her the necessary funds, in which case the higher SDLT rates will not be in point.

More on residences

For SDLT purposes, an individual is not able to elect which of two (or more) residences is to be regarded as his main residence and therefore the treatment of a main residence in this context may differ from the CGT treatment. The Government's view is that, although any elective treatment might reduce uncertainty, it would, in HM Treasury's view, 'be open to abuse and on balance (could not be) justified'. Whether a property is a main residence will simply be based on fact. The key considerations for arriving at a decision will include:

(i) where the individual and his family spend their time;

(ii) where any children go to school;

(iii) where the individual is registered to vote;

(iv) where the individual works;

(v) the location of his movable possessions; and

(vi) the correspondence and registration addresses given to various organisations.

Properties located abroad are counted as main or additional homes. If an individual owns a property overseas and he now wishes to purchase a residential property in the UK, the UK property will carry the 3% SDLT supplement.

Note that there is no special treatment for property which qualifies as furnished holiday accommodation.

Property held in trust

Beneficiaries with a life interest or an interest in possession in a settlement are treated as owning the trust property. Thus a beneficiary who either has a right to occupy the trust property or to receive the income from it is deemed to be the property owner for SDLT purposes. This rule does not, however, extend to interests in remainder or to interests under discretionary trusts.

Illustration 6

Adrian, the trustee of a new settlement for the benefit of Brian for life with remainder to Caroline, purchases a residential property. Brian owns no other property and is entitled, under the terms of the trust deed, to occupy the purchased property.

As this will be Brian's only property at the end of the day on which the transaction is completed, Adrian will not have to pay the higher SDLT rates. This is the case even if Caroline already owns a house or flat.
Of course, if Brian then bought a property of his own, he would have an interest in two properties and so would be liable to the higher rates of SDLT.

Discretionary trustees are always required to pay the higher SDLT rates when purchasing residential property. The property situation of the discretionary beneficiaries is irrelevant.

Purchases by a company

Originally, the Government proposed to include an exemption from the 3% SDLT supplement for large-scale investors in residential property. They have now decided not to go ahead with this idea. Therefore, the acquisition of property by anyone who is not an individual will always be subject to the higher SDLT rates.

Contributed by Robert Jamieson

SDLT and non-residential property **(Lecture B963 – 9.26 minutes)**

Following the enactment of SDLTA 2015 that abolished the long-established 'slab' system for SDLT on residential property acquisitions and replaced it with a progressive sliding scale (usually referred to as a 'slice' system), it was likely that the regime for non-residential (or mixed) property would be modified in a similar fashion. This has now happened and the relevant details can be found in Cl 116 FB 2016.

Hitherto, SDLT on non-residential properties has been calculated by reference to a percentage of the chargeable consideration for the property. For the last few years, the relevant table was:

Purchase price	*Rate*
Up to £150,000	0%
Over £150,000 and up to £250,000	1%
Over £250,000 and up to £500,000	3%
Over £500,000	4%

The SDLT on a commercial property costing £475,000 in January 2016 was 3% x £475,000 = £14,250.

The main criticism of the 'slab' system was its distorting 'cliff edge' effect. For example, if shop premises were priced at £250,000, the SDLT payable by the purchaser was 1% x £250,000 = £2,500. If, instead, they had cost £250,100, the SDLT would have been 3% x £250,100 = £7,503. In other words, the addition of £100 to the purchase price would have cost the buyer an extra £5,003 in SDLT. This represents an impressive (but iniquitous) marginal rate of tax!

Purchasers of non-residential property who complete on or after 17 March 2016 are subject to the same tax mechanism as has applied for over a year to residential property transactions. The new rates are:

Purchase price	*Rate paid on part of price falling within each band*
Up to £150,000	0%
Over £150,000 and up to £250,000	2%
Over £250,000	5%

If the property above had instead been bought in May 2016, the SDLT calculation is:

	£
On 150,000 @ 0%	–
On 100,000 @ 2%	2,000
On 225,000 @ 5%	11,250
	£13,250

This produces a saving of £14,250 – £13,250 = £1,000, compared with the same property being bought four months earlier.

However, it is possible for a purchaser to make an election in a land transaction return that the new calculation rules do not apply in two sets of circumstances. The first of these is where contracts were exchanged before 17 March 2016 and the contract was 'substantially performed' (ie. the purchaser occupied the property or paid over the whole, or substantially the whole, of the consideration) before that date.

The second is where contracts were exchanged before 17 March 2016 and the contract is completed on or after that date, provided that there is no event of a kind listed in Cl 116(15) FB 2016 which results in the effect of the contract on completion being different from the effect of the contract when first entered into. An example of this would be where the original terms of the contract were varied on or after 17 March 2016.

Contributed by Robert Jamieson

Administration

Discovery assessments and carelessness

Summary - The FTT allowed a taxpayer's appeal against a discovery assessment.

The issue was whether HMRC had been entitled to issue a discovery assessment, on the basis of an insufficiency of CGT brought about by the careless behaviour of the appellant (under TMA 1970 s 29(4)).

Mr Anderson had sold his 50% holding in a company to another company and the consideration had been an issue of shares. The issue was the market value of the shares sold.

The first question was whether there had been a discovery.

The next question was whether the insufficiency of tax had been caused by Mr Anderson's carelessness

Decision:

On the first question, the FTT found that, during an enquiry into Mr Anderson's return for 2008/09, it had newly appeared to the HMRC officer that additional CGT was due. She had become aware that the open market value of the shares was, in her colleagues' view, higher than that used by Mr Anderson. Following *Charlton*, this was a discovery.

The second question was whether the insufficiency of tax had been caused by Mr Anderson's carelessness. The FTT considered that the correct approach was to assess what a reasonable hypothetical taxpayer would have done in all the applicable circumstances of the actual taxpayer. The FTT found that Mr Anderson had done what could be expected of a person acting reasonably and diligently. He had relied on the advice of the corporate finance team of a leading accountancy firm and had fully considered 'whether it made sense'. Furthermore, an offer received from a third party, which had still been 'on the table' at the time of valuation, had been the best evidence of market value.

HMRC had made an application for postponement on the grounds that an enquiry into the relevant return had not been closed. However, referring to *Portland Gas*, the FTT noted that a closure notice did not need to be in a prescribed form. It therefore found that a letter from HMRC had constituted a closure notice, as it had mentioned the completion of its enquiry and set out its conclusions.

Comments – The FTT found that an HMRC officer had made a 'discovery' of an insufficiency of CGT in 2007–08, because during an enquiry into the taxpayer's 2008–09 tax return it became apparent that the open market value of shares used in the taxpayer's earlier return was lower than the Shares and Assets Valuation team considered appropriate. However the FTT found that this 'situation' was not brought about by the careless behaviour of the taxpayer, because the taxpayer relied on advice provided by a leading firm of accountants and he fully considered the basis for the advice and whether it made sense. In any event it was not careless to rely on a third party offer made for the purchase of the shares only days before the disposal date as the best evidence of the market value of the shares at that date.

As an aside to the decision, the appellant argued that the correspondence relied on by HMRC to evidence the ‘discovery’ did not suffice, especially as the HMRC officer was not called as a witness, based on the FTT case of Gardiner in 2014. In that case, Judge Cannan was critical of HMRC in seeking to rely on documents in the bundle produced to the tribunal as evidence as to the truth of their contents, without any supporting witness evidence, in a case where the onus was on HMRC to prove a prima facie case of negligence against the taxpayer. In this case, the FTT did not regard the *Gardiner* decision as authority that it would necessarily be inappropriate in all circumstances for the tribunal to accept documentary evidence of a discovery.

A Anderson v HMRC TC5092

Penalty for dishonest behaviour

Summary - The UT determined that the FTT had been wrong to find that the taxpayer had been dishonest.

The taxpayer set up a property development company and submitted VAT repayment claims. In 2005, after a VAT visit, HMRC asked for invoices to support the claim. The taxpayer asked the contractor to send copies of the invoices. The copies were, on the taxpayer's evidence to the First-tier Tribunal (TC2762), 'useless' but he passed them on to HMRC.

HMRC imposed a penalty under s60 VATA 1994 on the basis that the company had tried to obtain a VAT repayment dishonestly. Under s 61, the penalty could be recovered from a director of the company if the dishonesty was attributable to them. The First-tier Tribunal ruled that the taxpayer must have realised that, in submitting invoices which he knew to be useless, he was behaving dishonestly and upheld the penalty. The taxpayer appealed.

The issue was whether the First-tier Tribunal was justified in finding the taxpayer dishonest.

Decision:

The Upper Tribunal referred to the taxpayer's evidence that he had described the copy invoices as being 'useless' because they were nothing like the ones the contractor should have produced. However, he thought the original invoices had been submitted earlier and passed the copies to HMRC because he had been asked to. He felt he had no alternative but to submit them because they were the only ones he had.

The judge said he could not be satisfied that the First-tier Tribunal's conclusions on dishonesty were justifiable. He could not rule out the possibility that the taxpayer genuinely believed the copy invoices were poor substitutes for the original ones.

As a result, he allowed the taxpayer's appeal, but said he was not in a position to reach a conclusion on the dishonesty issue. The case should therefore be remitted to the First-tier Tribunal.

Comments – The Upper Tribunal quoted 'the more serious the allegation the less likely it is that the event occurred and, hence, the stronger should be the evidence'. As can be seen, the evidence against the taxpayer was not sufficiently compelling in the judge's view.

P Brookes v CRC, Upper Tribunal

Penalty reduced - nature of input tax errors

Summary – The FTT found that HMRC was entitled to raise the assessments and impose the penalties.

The taxpayer was assessed for input tax errors and a 'deliberate error not concealed' penalty of 70% under FA 2007, Sch 24. He registered for VAT from February 2008. The VAT returns had entries for inputs and input tax claims only. No outputs were shown. HMRC began enquiries in May 2013 and disallowed the input tax claims.

When the taxpayer had first applied to be VAT-registered, he stated that his business was to import and sell goods, including 'basmati rice, working gloves, kitchen towel and small leather items'. However, in 2013, the business was buying clothes from retailers in the UK and exporting them to overseas stores. The taxpayer accepted that he had not gone through the correct procedures to export goods on a free-of-VAT basis, but said he had not realised this at the time. Further, he used personal baggage to avoid customs duties in the overseas territories.

The taxpayer claimed that he had ceased to trade in 2013 because of illness and that his only income was now from benefits.

Another issue was a lack of business records. The taxpayer said his son, who was abroad, had control of the records, but he later claimed that they had been put in storage and the owner of the facility that held them had destroyed them by mistake.

Decision:

The First-tier Tribunal described the taxpayer's claim that a business existed was 'insufficiently persuasive' and contained 'material inconsistencies'. The judge found that the taxpayer had 'on a balance of probabilities' acted deliberately in completing VAT returns inaccurately. HMRC was entitled to raise the assessments and impose the penalties.

However, the judge reduced the penalty from the maximum 70% to 60% on the basis that a degree of co-operation and help had been given to HMRC by the taxpayer in that he had replied to some communications.

The taxpayer's appeal was dismissed.

Comments - The appellant did not attend and was not represented. Therefore it is not suprising that the appeal would be dismissed.

Group One (A Mehmood) v HMRC TC4986

The wrong form - Error not capable of correction

Summary - The First-tier Tribunal found that there was no legislative provision for retrospective withdrawal and replacement of an EIS compliance statement and that because shares had been issued and a compliance statement provided, an EIS investment had been made so that the company was no longer a qualifying company for SEIS purposes.

The taxpayer applied for clearance to supply a compliance certificate enabling its investors to claim seed enterprise investment scheme (SEIS) relief at 50% (S257EB ITA 2007). But it used the EIS1 form (applicable to the enterprise investment scheme under which relief is allowed at 30%) instead of the SEIS form. HMRC authorised the taxpayer to issue EIS compliance certificates. The mistake went unnoticed until the taxpayer applied for a further compliance certificate. HMRC refused this on the ground that there was an earlier EIS investment, which precluded the company from using SEIS.

The taxpayer asked HMRC to accept a SEIS application instead of the EIS one but it refused. The taxpayer appealed.

Decision:

The First-tier Tribunal was 'entirely satisfied' that the taxpayer had intended to apply for SEIS authorisation and that it had made an innocent mistake in using the wrong form. The judge said it was clear that EIS relief had been granted and there was no provision to set it aside. S42(9) TMA 1970 which allows a taxpayer to correct an erroneous claim within the relevant time limit, did not apply because the compliance certificate did not amount to a claim.

The tribunal sympathised with the taxpayer that 'an adverse result of some magnitude should follow from a simple clerical error', but it had no option but to dismiss its appeal.

Comments - Although the Tribunal judge had some sympathy with the appellant's argument that a simple clerical error should not give rise to an adverse result for its investors, it was not within his power to allow an appeal because its consequences were perceived to be unfair (R & C Commrs v Hok Ltd)

X-Wind Power v HMRC TC5086

Was a discovery assessment valid?

Summary - The FTT dismissed a taxpayer's appeal against a discovery assessment. The disclosure made in a trust return was not information that a hypothetical HMRC officer could have inferred existed and was relevant based on the taxpayer's return.

Mr Miesegaes (the appellant) had established a trust of which he was the life tenant and a Guernsey company was the trustee. The trustee had entered into a partnership which traded in property in the UK. The appellant received, as life tenant, the trust's share of the profit and had declared this income in his tax return, claiming 100% tax relief on it under the UK-Guernsey double tax treaty. The return included a 'white space' disclosure advising that a form 41G (Trust) had been submitted in relation to the trust.

The trustee had also submitted a tax return for the trust which included a large 'white space' disclosure, which HMRC accepted, had it been in the appellant's tax return, would have been sufficient to reveal to HMRC that the appellant had claimed a relief to which he was not entitled. It included, in particular, the information that the settlement had traded in partnership.

HMRC had raised a discovery assessment on the basis that the appellant's claim for relief arising under the UK-Guernsey double tax treaty was, by retrospective legislation, 'beyond doubt' invalid. The appellant accepted that he was not entitled to the claimed tax relief (because the scheme had been retrospectively closed), but appealed on the grounds that: (1) the information in the white space of the trust tax return was information the existence of which and the relevance of which should have been inferred before the enquiry window had closed (s29(5) TMA 1970); (2) in any event, the information contained in the appellant's tax return meant that HMRC should have been aware of the insufficiency at the time the enquiry window closed; and (3) HMRC did not make a discovery within s29(1) TMA 1970 or at least, if they did, they failed to act on it promptly.

Decision:

The primary dispute was whether the effect of s29(6) TMA 1970 was to treat the hypothetical HMRC officer as having had the trust tax return made available to him. The FTT found that when the enquiry window closed, the information contained in the white space disclosure on the trust tax return was not information the existence of which and the relevance of which to the insufficiency in the appellant's assessment could reasonably have been expected to be inferred by an officer of HMRC from information within s29(6) (a)-(c) TMA 1970 and in particular it could not reasonably have been expected to be inferred from entries in the appellant's tax return.

The secondary dispute was whether the information in the appellant's tax return indicated the insufficiency. The appellant's case was that on HMRC's view of the law at the time, no UK resident could have claimed exemption under a double tax treaty for income paid to them as life tenant from a non-resident trust. As it was clear that the appellant was claiming such exemption the hypothetical officer had had enough information before him to be aware of the insufficiency in the appellant's return. Based on the Court of Appeal case of Sanderson v R & C Commrs in 2016, it seemed to the FTT that the hypothetical officer was not fixed with HMRC's view that the scheme did not work unless the taxpayer drew this to the officer's attention in his disclosure. But where the law was clear that on the facts disclosed by the taxpayer that there was an insufficiency, then the hypothetical officer was fixed with knowing this, save where the law was too complex (which was not suggested in this appeal). In this case this meant that on the date the enquiry window closed, it was clear that a UK resident life tenant of a trust trading in partnership in the UK at any time was not entitled to relief under the UK-Guernsey double tax treaty, art. 3(2), because the law had been changed with retrospective effect. The FTT found that from the appellant's return at the date the enquiry window closed the hypothetical officer had known that the appellant had received income as life tenant of a trust and had claimed the income was exempt under the UK-Guernsey double tax treaty, art. 3(2). However as he did not know that the trust traded in partnership he did not have an awareness of an actual insufficiency.

As part of the FTT's considerations, the FTT found that the test for an assessment and the test for a bar on discovery are not the same. HMRC may have sufficient disclosure to raise a discovery assessment because of a 'possible insufficiency' under s29(1) TMA 1970 but that disclosure may be insufficient to protect a taxpayer from such an assessment because the disclosure did not create awareness of an actual insufficiency.

Finally, the FTT considered whether there had been a discovery (in the light of the Upper Tribunal decision in Burgess, Brimheath Developments Ltd v R & Commrs in 2015). The FTT found that the discovery was made by an HMRC officer just before the assessment was raised. However, even if the discovery had been made two years earlier by a different officer, as contended by the appellant, the assessment would still have been valid as in the FTT's view, it was irrelevant when the discovery was made as long as there was discovery. There was nothing in s29(1) TMA 1970 which imported any prohibition against a time lag between the discovery and assessment. This view was contrary to obiter comments made in R & C Commrs v Charlton in 2013, that a discovery assessment should not be made too long after the discovery.

The appeal was accordingly dismissed.

Comments - The information in the taxpayer's return itself did not include enough information for the hypothetical officer to be aware of the insufficiency in the return. The discovery would have been valid even if the discovery took place two years before the assessment was raised.

In respect of the validity of the discovery, the FTT found as fact that the discovery assessment was made very shortly after the discovery, which was enough to dispose of this part of the appeal. But the FTT also considered whether stale discoveries voided assessments. The FTT decided not to follow the comments made in the Upper Tribunal case of R & C Commrs v Charlton in 2013, that a discovery assessment should not be made too long after the discovery. Judge Mosedale considered the comment to be obiter and therefore not binding on the FTT, and instead found there to be nothing in s29(1) TMA 1970 about how soon an assessment must follow a discovery.

Miesegaes v HMRC TC5129

Information notices and non-resident taxpayers

Summary - The FTT approved HMRC's application for an information notice to be given to a taxpayer. The FTT did not record the reasons why it was satisfied that the relevant conditions for approval were met, but set out its conclusions on matters likely to be of general interest. These included whether there was a right to a public hearing, jurisdictional issues and the relevance of assessment processes.

HMRC made a without notice application to the FTT under Para 3 Sch 36 FA 2008 for the approval of an information notice. In the course of the FTT's considerations it looked at several representations made on behalf of the taxpayer. As Judge Berner considered these point to be of general interest he decided to publish the conclusions reached.

The FTT granted HMRC's application that the hearing should be in private, pursuant to r32 of the *Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules* 2009 (SI 2009/273 or 'the Rules'). Given that the application for approval of the information notice was made without notice as allowed by para 3(2A) Sch 36 FA 2008 only the limited information described in para. 3(3)(c) had to be provided to the taxpayer and the procedural requirements as to the provision of documents and participation of the taxpayer were disapplied under r19 of the Rules. In those circumstances, in the absence of the taxpayer, it would not be in the interests of justice to allow the public to hear the details of the taxpayer's personal and financial circumstances which may be put before the tribunal to support the application.

Representations on behalf of the taxpayer raised two jurisdictional questions:

1. the jurisdiction with respect to the liability of the taxpayer to UK tax; and
2. the jurisdictional reach of Sch 36 FA 2008 itself.

On the first question, HMRC's investigation, which had led to the Sch 36 FA 2008 application, was concerned with whether the taxpayer was resident in the UK over a period. Whatever the residence status of the taxpayer at the time the notice was issued, were he to be found to have been UK resident in the relevant period he may be liable to UK tax. There was therefore no question of there being no jurisdiction with respect to the taxpayer's tax position. Additionally, representations of this nature, which essentially go to the substantive case that might arise, were not such as to render the information not 'reasonably required', as provided by para 1(1) Sch 36 FA 2008.

On the second question, although the taxpayer notice was intended to be addressed to the taxpayer at an address outside the jurisdiction, this did not, in Judge Berner's judgment, exclude the power of HMRC to give such a notice under para1 Sch36 FA 2008. In Judge Berner's judgment the territorial scope of Sch 36 FA 2008 had to match the territorial scope of the liability to tax.

Judge Berner also decided that representations made on behalf of the taxpayer concerning the requirements to be met before HMRC could issue discovery assessments were not relevant to the reasonableness of HMRC's enquiries, including the giving of a taxpayer notice.

As is usual practice Judge Berner did not record in this decision why he was satisfied that all the relevant conditions for approval were satisfied.

Comments - One of the representations made on the taxpayer's behalf concerned the applicability of HMRC's power to issue an information notice to a taxpayer outside the UK. Given that the FTT found that it was reasonable for HMRC to check the person's UK tax position, which as it was a case where residence was an issue included consideration of the territorial reach of UK tax, such a person had to, in the words of Lord Wilberforce, in Clark (HMIT) v Oceanic Contractors Incorporated in 1982 fall within the legislative grasp or intendment of Sch 36 FA 2008.

Taxpayer v TMRC TC5116

Notification of arrangements under DOTAS

Summary – The High Court found that transactions had been notifiable under DOTAS. Consequently both APNs and PPNs were valid

The claimants took part in Liberty Partnership schemes. They challenged the legality of accelerated payment notices (APNs) and partnership payment notices (PPNs) issued to them under s219 FA2014. They said condition C (s 219(4)) was not satisfied because the schemes had not been notifiable.

This was because the relevant first date for notifying the arrangements under the disclosure of tax avoidance schemes (DOTAS) provisions in s308 FA2004 had fallen before 1 August 2006.

Decision:

The High Court said the focus should be on the specific partnership. Each one had its own particular components, in terms of the identity of the partners, the amounts subscribed, the identity of the corporate vendor of the relevant dividend rights, the identity of the payer of the relevant dividend, the amount of the relevant dividend, the alleged tax advantage and the rights and obligations of each partner to the other partners in the individual partnership.

There was no justification for sweeping all the individual partnerships under a single 'umbrella' arrangement.

On this basis, the arrangements were notifiable because they had been implemented after 1 August 2006 even if the proposal had been made before then.

The application for judicial review was dismissed.

Comments - The High Court found there was no justification for sweeping all the individual partnerships under a 'single “umbrella” arrangement'.

R (on the application of Graham and others) v CRC QBD

FTT's jurisdiction

Summary - The FTT found that it did not have jurisdiction to hear an appeal against a decision made by a complaints department of HMRC.

Mr Percival, a resident in the Republic of Ireland, had exchanged correspondence with HMRC relating to the taxation of his pension in the UK. At the conclusion of the correspondence, HMRC had decided that his pension was fully taxable in the UK under the UK/Ireland double tax treaty and indicated steps Mr Percival could take if he felt that his complaint had not been dealt with properly. Instead of following these steps, the taxpayer had lodged an appeal with HM Courts & Tribunals Service, which had informed him that HMRC's decision was not appealable. However, following further correspondence, the appeal had been allocated to proceed under the standard category.

Decision:

The FTT observed that it was a statutory tribunal so that it only had jurisdiction over matters on which the relevant legislation specifically granted rights of appeal. As the taxpayer had been corresponding with HMRC's PAYE and Self-Assessment Complaints Service, any review which might have been carried out by that department would have been an internal administrative procedure not giving rise to a statutory review, so that no right of appeal arose.

The FTT concluded that under rule 8(2)(a), it had to strike out the appeal as it had no jurisdiction.

Comments - The FTT commented that it would not have allowed the relevant appeal to be lodged.

K Percival v HMRC TC 5077

Deliberate or careless behaviour

Summary – The FTT found that the behaviour was careless not deliberate and mitigated the penalty for co-operation.

E used to provide her services through C&D but the company was wound up and she set up the taxpayer company (APM). C&D claimed input tax on its September 2014 VAT return for an invoice it had paid APM. However, the equivalent output tax was not declared in APM's September return. She should have declared output tax because she was on the cash accounting scheme so the gross receipts received from C&D should have been treated as VAT inclusive.

An HMRC visiting officer said E had submitted two VAT returns where output tax was missed off one but input tax claimed on the same transaction on the other. The officer imposed a 20% penalty on the basis that this constituted unprompted disclosure of a deliberate error not concealed. The disputed VAT return was completed by the company's external accountants who took responsibility for the mistake.

Decision:

The First-tier Tribunal said E had made a careless rather than a deliberate error. The judge said she 'did not knowingly and intentionally provide an inaccurate document to HMRC. She made a mistake and [her accountant] made a mistake. But we all make mistakes despite our best efforts.'

The tribunal added that it accepted the HMRC officer's record of events but not some of the inferences that he took from them. Given that some taxpayers would try to gain an advantage by failing to disclose full information, it was to be expected that the officer would 'employ a healthy scepticism in assessing their explanations'.

In this case, E (and her adviser) had made an innocent mistake. However, the tribunal agreed that the mistake was due to a lack of reasonable care and was therefore careless.

The taxpayer's appeal was allowed and reduced the penalty to nil on the basis that the taxpayer had been co-operative and helpful once the error had been discovered.

Comments – This case is a practical demonstration of the situation of where penalties can be mitigated by co-operation even though they should have been avoided in the first place.

Auxilium Project Management Ltd v HMRC TC5024

Reasonable excuse for late payment

Summary - The FTT stated that the taxpayer had a reasonable excuse for the late payment of VAT.

HMRC had received the relevant VAT return in time on 6 November 2015; however, when it had originated the direct debit on 11 November 2015, it had been returned unpaid because the amount of £27,000.71 had exceeded the balance of cleared funds available in the account by £1,784.61. The company had had no overdraft facility.

Decision:

The FTT observed that although an insufficiency of funds does not provide a reasonable excuse, *Steptoe* in 1992 had established that the reason for the lack of funds might provide a reasonable excuse.

The FTT also noted that the company had overpaid PAYE by £3,500 and that HMRC had been one year late in repaying it. Without this delay, the company would not have been short of funds and the direct debit would have gone through. HMRC's delay therefore constituted a reasonable excuse.

Comments - The cases are relatively rare where the taxpayer successfully claims a reasonable excuse for the late payment of tax. This case should be a reminder to taxpayers that when HMRC behaves unfairly, taxpayers should appeal through the Tribunals.

PR Powersaving Solutions v HMRC TC5140

Validity of a notice of enquiry

Summary - The First-tier Tribunal allowed a taxpayer's appeal against a closure notice. The FTT found that an enquiry had not been opened because no valid notice of enquiry had been given as the enquiry letter referred to the year ended 6 April 2009 instead of the year ended 5 April 2009.

In January 2011, HMRC opened an enquiry into the taxpayer's 2008-09 return on the basis that he had taken part in a tax avoidance scheme. HMRC concluded that a further £653,000 tax was due and issued a closure notice in July 2014.

The taxpayer appealed, saying no enquiry had been opened because no valid notice of enquiry was given. As a result, there could be no valid closure notice.

He said the enquiry notice had attempted to open an enquiry into a non-existent return because it referred to his tax return for the year end 6 April 2009 instead of 5 April 2009. HMRC said the error was minor and it 'must have been clear to the appellant which return was under enquiry'. Further s114 TMA 1970 'Want of form or errors not to invalidate assessments, etc' could be taken to correct the error.

The matter proceeded to the First-tier Tribunal.

Decision:

The tribunal judge said s114 could not rectify the mistake because the letter in question did not satisfy the requirements in the provision. The section states:

'An assessment, warrant or other proceeding which purports to be made in pursuance of any provision of the Taxes Acts shall not be quashed, or deemed to be void or voidable, for want of form, or be affected by reason of a mistake, defect or omission therein, if the same is in substance and effect in conformity with or according to the intent and meaning of the Taxes Acts, and if the person or property charged or intended to be charged or affected thereby is designated therein according to common intent and understanding.'

The return described in the letter was for a tax year that did not exist. The tribunal concluded therefore that the disputed notice did not 'in substance and effect' conform with the legislation.

The judge ruled that the notice did not constitute a valid notice of enquiry into the taxpayer's 2008-09 return under s 9A. Further, 'without a valid enquiry notice, there was no enquiry and the purported closure notice has no standing'. HMRC was out of time to raise a discovery assessment for the year and therefore the taxpayer's liability would be settled according to the computations shown in his tax return.

The taxpayer's appeal was allowed.

Comments - This case highlights the importance of carefully checking any enquiry letters, penalty notices etc. received from HMRC, to ensure that they adhere to what is legally required before deciding how to act on them.

By HMRC using a date that was one day out they have potentially cost the UK exchequer £653,000 in tax revenue, as this was the amount of tax at stake in the substantive case which concerned the effectiveness of a DOTAS registered tax scheme.

An HMRC spokesperson said: 'We are disappointed with the tribunal's decision and are considering whether to appeal.'

M Mabbutt v HMRC TC5075

Conditions to suspend a penalty for careless inaccuracy

Summary – The Tribunal found that although there was a valid penalty for careless behaviour HMRC should have reviewed their decision.

The taxpayer submitted his 2013-14 tax return using the information on his form P60. However, this did not include income from his previous employment.

The error came to light after HMRC opened an enquiry into the return. The officer amended the form and imposed a penalty for carelessness. He said the penalty could not be suspended because it was 'not likely' that the taxpayer would repeat the error in future returns.

The taxpayer appealed.

Decision:

The First-tier Tribunal accepted that it was a genuine and honest mistake but that it was a careless one. It 'should have been obvious' to the taxpayer that the P60 did not include all his earnings for the year.

The judge said further that HMRC had applied the penalty proportionately.

However, the decision not to suspend it was 'flawed'. The officer had not said on what evidence he had reached his decision; he did not appear to have considered whether the taxpayer would have to file a return in the next two years, even though 'as a matter of fact' he would have to; there was no evidence that any conditions were considered; the letter suggested that the legislation restricted the conditions for suspension to the chance of making the same error but this was too narrow a view; and the officer should have considered the possibility of making it a condition that the taxpayer take professional advice when submitting future returns.

The taxpayer's appeal was allowed to the extent that HMRC should suspend the penalty.

Comments – The case demonstrated that the decision not to suspend it was 'flawed' and accordingly the taxpayer's appeal was allowed to the extent that HMRC should suspend the penalty

I Hall v HMRC TC5166

Discovery and the hypothetical officer

Summary - The UT found that HMRC had validly made a discovery. HMRC could not have been aware of the insufficiency of tax when the enquiry window closed.

Mr Pattullo had entered into a tax avoidance arrangement in the 2003/04 tax year. The arrangement had involved the use of capital redemption contracts (CRCs) and had sought to take advantage of the wording of s37 TCGA 1992. Some 925 participants in the scheme had been identified and 909 enquiries opened. However, at the time Mr Pattullo had submitted his return, disclosure of the CRC scheme had not been required by law. It was ultimately held that the scheme did not achieve its purpose.

The first issue was whether a discovery could comprise a series of discoveries.

The second issue was the level of knowledge and expertise to be expected of the hypothetical officer, when deciding whether he should have been aware of the insufficiency of tax)

Decision:

With the first issue the FTT had found that the threshold had been crossed in the period June to November 2009, when the *Drummond* case in 2009 (which concerned a similar scheme) had been decided by the Court of Appeal and leave to appeal had been refused. The UT detected no error of law in this finding.

Mr Pattullo also argued that s29(1) TMA 1970 required HMRC to make an assessment immediately upon making a discovery. The UT agreed, noting that the requirement for the discovery to be acted upon while it remained fresh arose on the natural meaning of s 29(1) itself. However, the FTT had found that the discovery had been made sometime between July and November 2009 and that the assessment had been made in January 2010. The discovery had therefore not been stale by the time of the assessment.

The second issue was the level of knowledge and expertise to be expected of the hypothetical officer, when deciding whether he should have been aware of the insufficiency of tax (s29(5) TMA 1970). The UT thought that the discovery in sub-s (1) found its counterpart in the state of awareness in sub-s (5).

The question of reasonableness therefore came not in the need to construct a fictional hypothetical officer, but rather in the test of whether the actual officer ought reasonably to have been aware of the insufficiency.

The UT found that in January 2006 (when the enquiry window had closed), a hypothetical officer would not have had any real understanding of the world of CRCs. Furthermore, the *Drummond* case had only reached the Court of Appeal in 2009. The FTT had therefore been right (although it had erred in law when ascertaining the characteristics of the hypothetical officer) to find that the hypothetical officer could not have been aware of the insufficiency.

Comments - The UT clarified the meaning of 'discovery'. The UT further refined the concept of reasonableness of 'the hypothetical officer'. It pointed out that the question of reasonableness should arise as an objective test, by reference to the standards of knowledge and expertise reasonably to be expected of an HMRC officer. Accordingly the question was: whether the officer's lack of awareness of the insufficiency as at the relevant date could properly be categorised as unreasonable.

N Pattullo v HMRC UT

Closure notice and notice under Sch 18 FA 1998

Summary - The UT decided that a Para 34(2A) Sch 18 FA 1998 notice and a closure notice did not have to be issued at the same time.

HMRC had denied the company's claims for the carry forward of losses and for relief under the intangible fixed asset rules in respect of the purchase and amortisation of goodwill. It had sought to do so in closure notices in respect of enquiries opened into Spring Capital's company tax returns for 2007 and 2008.

HMRC now accepted that the closure notice issued in June 2010, in respect of the 2008 period, might not be valid because the notice of enquiry for that period had not been delivered to Spring Capital before the end of the enquiry window on 30 April 2010.

In December 2010, HMRC had issued a para 34 (2A) Sch 18 FA 1998 notice, purporting to make consequential amendments to Spring Capital's company tax return for the 2008 period by disallowing the two claims.

DecisionThe first issue was whether a notice given under sub-para 2A should be given at the same time as the closure notice. The UT found that the natural meaning of the words in para 34 was that there was no fixed time limit for the issue of a notice under sub-para (2A).

The UT added that sub-para (2A) referred to the notice of a consequential amendment as a 'further notice'; and therefore contemplated that the notice under sub-para (2A) may be separate and distinct from the closure notice and could be issued at a later time.

Finally, the UT found that the provisions produced a fair and just result, so that there was no need for the tribunal to infer words such as a requirement for the notice under sub-para (2A) to be issued 'within a reasonable time' of the relevant closure notice.

Comments - The UT highlighted that the purpose of sub-para (2A) was to provide a limited power to HMRC to make amendments to other returns. This was in order to ensure that they remain consistent with the decisions made in the relevant closure notice in circumstances where it may be unable to open an enquiry or issue a discovery assessment. Therefore, sub-para (2A) amendments did not need to be given at the same time as the closure notice.

Spring Capital v HMRC UT

Too big to miss - Deliberate or careless output tax errors

Summary – The Tribunal held that HMRC had proved dishonesty on the part of the taxpayers.

During a VAT compliance visit in 2014, the HMRC officer found output tax errors as a result of the bookkeeper preparing calculations from manual records rather than by using the company's Sage system. Many sales invoices were included in that system but excluded from the manual records, resulting in understatements. HMRC issued assessments to recover the VAT and also a 42.5% penalty on the basis that the errors were 'deliberate but not concealed'.

The taxpayer appealed. The directors said they relied on the bookkeeper to deal with the VAT returns. Although acknowledging that they should perhaps have checked the forms more carefully, they admitted that they had looked only at the VAT due to be paid. The directors also highlighted personal problems of the bookkeeper as contributing to the errors. But HMRC felt that these should have encouraged the directors to show more interest in the VAT accounting issues.

HMRC went on to say the understated figures were significant and the directors should have noticed. Further, the errors always produced underpayments of tax even though the input tax figures were always correct. Finally, even though the directors may not have felt confident using Sage, they should have instructed the bookkeeper to use it. This would have ensured the correct figures were captured.

Decision:

The key point for 'deliberate' penalties is that HMRC has to prove dishonesty on the part of the taxpayers. The First-tier Tribunal decided it had discharged that burden. The errors were large and the tribunal thought the directors could not have failed to spot them. The inaccuracies were deliberate and the penalty was justified. The taxpayer's appeal was dismissed.

Comments – The directors had a clear responsibility to check the VAT returns. The errors were very large and the tribunal thought the directors could not have failed to spot them. The inaccuracies were deliberate and the penalty was justified. This demonstrated that responsibility cannot be completely abrogated.

Gryson Air Conditioning Equipment Ltd v HMRC TC4963

Unauthorised issue of an invoice showing VAT

Summary – The First-tier Tribunal found that the company director was aware of the link between being registered for VAT and the obligation to account for it. The behaviour was therefore deliberate

The taxpayer registered for VAT in 2008 but the registration was cancelled on 12 March 2009. However, it issued VAT invoices to a customer between 10 March 2011 and 31 July 2013.

The main reason for this was because one of its clients asked it to charge VAT on all future sales. The company director agreed to this request although he ringfenced the VAT element because he recognised that the company was not entitled to it and that it would have to be paid to HMRC or returned to the customer. But he failed to recognise that an invalid VAT charge is a debt to the Crown even though the company was not VAT-registered and the supplies were exempt.

On this basis, in April 2014, HMRC assessed the VAT due and this was paid by the taxpayer. It also imposed a penalty under para 2 Sch 41 FA 2008 for the unauthorised issue of a VAT invoice. The penalty was calculated on the basis that the incorrect VAT charge had been caused by 'deliberate not concealed' actions. The taxpayer appealed.

Decision:

The First-tier Tribunal found that the company director was aware of the link between being registered for VAT and the obligation to account for it. Further that he realised the company should not be issuing VAT invoices when it was not registered. The behaviour was therefore deliberate. The judge felt it appropriate to add that neither the company nor the director had been 'in any way dishonest'. This was clear from the ring-fencing of the VAT and the co-operation with HMRC.

However, the underpaid tax was disclosed to HMRC only when it made enquiries about the company in August 2013. As a result, the disclosure was prompted. The penalty was correct.

The taxpayer's appeal was dismissed.

Comments – The decision is self-explanatory and the Tribunal probably made the right decision.

Kinesis Positive Recruitment Ltd v HMRC TC4964

Deadline Dates

1 July 2016

- Payment of corporation tax for periods ended 30 September 2015, if not liable to pay by instalments.

5 July 2016

- Date of submission of Non-resident landlords' scheme forms NRLY and NRL6.
- Date to report non-cash benefits not from a registered pension scheme.

6 July 2016

- Forms P9D, P11D, P11D(b) for 2015/16 must be completed by this date.
- Due date to provide employees with 2015/16 benefits information.
- PAYE settlement agreements for 2015/16 must be finalised by this date.
- Taxed award scheme returns due by this date.
- Details of redundancy packages for 2015/16 worth more than £30,000must be submitted to HMRC by this date.
- Filing date for forms 42.

7 July 2016

- Due date for VAT return and payment for 31 May 2016 (electronic payment).
- Due date for election to aggregate beneficial loans in 2015/16.
- File forms EMI40 by this date.

14 July 2016

- Due date for CT61s for quarter ended 30 June 2016.
- Due date for monthly EC sales list if paper return used.

19 July 2016

- Pay PAYE/CIS for month ended 5 July 2016 if by cheque by this date.
- Pay PAYE liability for q/e 5 July 2016 if average monthly liability is less than £1,500 by this date.
- Payment of 2015/16 Class 1A NICs by cheque due by this date.

21 July 2016

- Online monthly EC sales list due by this date.

- Intrastat — due date of payment of June 2016 supplementary declaration.

22 July 2016

- Due date for PAYE/NIC/student loan payments if being paid online.
- Pay 2015/16 class 1A NICs electronically by this date.

31 July 2016

- Companies House should have received accounts of private companies with 31 October 2015 year end by this date.
- Second 5% surcharge for unpaid 2014/15 balancing payments due.
- 2015/16 second instalment SA liabilities are now due.
- Tax credits claims renewed by this date.
- Companies House should have accounts of plcs with 31 January 2016 year end filed by this date.
- CTSA returns for accounting periods ended 31 July 2015 due by this date.
- Annual adjustment for VAT partial exemption claims, April year end by this date.

HMRC News

Off-payroll working in the public sector: reform of the intermediaries legislation

HMRC has launched a consultation, Off-payroll working in the public sector: reform of the intermediaries legislation (tinyurl.com/jrw9pxj).

It sets out how the changes, announced in this year's Budget, will work. Their purpose is to make public sector bodies and agencies responsible for operating the tax rules that apply to off-payroll working in the public sector.

The government is keen to understand how digital support might be developed to help provide certainty from the start of contract negotiations between an engager and worker.

This consultation document covers:

- the scope of the new rules;
- how they will work;
- minimising burdens on engagers; and,
- a summary of responses to last summer's 'Intermediaries Legislation (IR35): discussion paper'.

The basis on which the rules are applied to determine whether a worker would have been an employee if engaged directly is not changing. Rather, the new rules move the liability to make the determination about whether the intermediaries rules apply — and the associated tax liability — from the personal service company to the public sector end-client or agency or other third party.

The government intends to use the definition of public sector set out in the Freedom of Information Act 2000 and the Freedom of Information (Scotland) Act 2002.

The definition does not cover private companies that carry out public functions for the state, such as a private healthcare company running an urgent care centre at an NHS hospital or charities working in the public sector.

Responses should be emailed by 18 August 2016 to: off-payroll.consultation@hmrc.gsi.gov.uk.

HMRC taskforces raise more than half a billion

HM Revenue and Customs (HMRC) taskforces have recovered more than £500 million since they were launched five years ago.

The targeted bursts of enforcement activity have brought in progressively higher amounts every year, and the total now stands at more than £540 million. This includes nearly £250 million raised in 2015-16 alone, almost double the previous year's yield.

Since 2011, HMRC has launched more than 140 taskforces targeting sectors that are at the highest risk of tax fraud including the retail sector, the tobacco industry and the adult entertainment industry.

Jennie Granger, Director-General for Enforcement and Compliance at HMRC, said:

> The message is clear: if you try to cheat on your tax, we are going to catch you. A small number of people still think they can cheat the tax system; these figures prove we can track them down and take back what they owe.
>
> We have increasing levels of intelligence, and use state-of-the-art digital tools to help us to identify and target high-risk areas.
>
> Taskforces are just one strand of HMRC's compliance strategy, which brought in a record £26.6 billion in 2014-15, up 43% from 2011-12.
>
> Nearly 50 new taskforces were launched last financial year, including ones targeted at property, partnerships and hidden wealth. In 2015, a single taskforce focused on Income Tax led to 45 arrests for tax evasion and fraud.

Money brought in through taskforces in previous years:

Year	Taskforces yield
2011-12	£24.3 million
2012-13	£47 million
2013-14	£85 million
2014-15	£138.1 million
2015-16	£248 million

HMRC service standards for personal customers

HMRC responds to National Audit Office criticisms with best customer service performance in years. The National Audit Office (NAO) has published a report today criticising HM Revenue and Customs (HMRC) for periods of poor customer service last year. HMRC has made significant improvements since then and we're offering our best service in years.

Responding to the report, Ruth Owen, HMRC's Director General for Customer Services said:

> We recognise that early in 2015 we didn't provide the standard of service that people are entitled to expect and we apologised at the time. We have since fully recovered and are now offering our best service levels in years.
>
> Over the past six months we've consistently answered calls in an average of six minutes, and have launched new online tax accounts and webchat for everyone, enabling customers to manage their tax affairs wherever and whenever they want.
>
> There's never been a better or more convenient service for our customers.

HMRC achieved improvements to customer service by:

- recruiting more than 3,000 additional advisers who can work outside normal office hours when many customers choose to call HMRC
- introducing more flexible working to deal with large fluctuations in customer demand throughout the year, underpinned by a new telephone system that enables HMRC to move calls around the country in response to demand
- launching online services that enable customers to manage their tax affairs when and where they want, including by smartphone, with online support such as webchats. The new personal tax account already has more than 1.5 million users and the business tax account more than five million registered users

HMRC average speed of answering calls (minutes)

May 2015	19
June 2015	20
July 2015	10
August 2015	15
September 2015	15
October 2015	17
November 2015	8
December 2015	6
January 2016	5
February 2016	5
March 2016	6
April 2016	6
May 2016 (to date)	5

HMRC is now consistently achieving the best customer service levels in years, and announcements by the Chancellor in the 2016 Budget will improve it further, through:

- introducing a seven-day service by April 2017, with extended hours and Sunday opening on main phone lines, as well as online support services like webchats
- recruiting more than 800 new staff into the customer services teams, to reduce call answering times and further increase the flexibility to respond to demand
- a new secure email service – operated through customers' online tax accounts – with a faster average response time than the current post handling target

HMRC's expanding online services are giving customers new, easier, faster and more convenient ways to deal with HMRC, and the investment in IT and flexible working is continuing to improve more traditional customer services.

Nearly ninety per cent of self assessment taxpayers now send in their returns online and last year HMRC received 55,000 tax credit renewals on the deadline day, bringing the online tax credit total for the year to more than 750,000.

In Spending Review 2015 the Chancellor invested £1.3 billion in HMRC to enable HMRC to transform how we interact with our customers and to make HMRC a world leader in digital services and customer service.

Business Taxation

Was a trade carried out commercially?

Summary - The First-tier Tribunal dismissed a taxpayer's appeal against HMRC's closure notices disallowing his loss relief claims in respect of his activities as promoter of his wife's career as a concert pianist. While the FTT found that the activities amounted to a trade they found that the trade was not carried on on a commercial basis or with a view to the realisation of profits of the trade.

Mr Gray ran a sole practice as a tax attorney and counsellor at law. His wife was a concert pianist and he had become her promoter.

HMRC had opened an enquiry into his return and had found that the losses claimed by Mr Gray were invalid, as he had not carried out the trade of promoter; or, alternatively, he had not carried out this trade on a commercial basis or with a view to profits (s66 ITA 2007).

Decision:

The FTT observed that the question of motivation must have some relevance to the 'trade' issue, as well as that of commerciality. The FTT accepted that Mr Gray had believed that the business of promoting his wife would be commercially successful. He had agreed with her that if he funded the promotion business, the fees generated would belong to him until he had recouped what he described as his 'capital outlay', and then subsequently the fees derived from her music career would be divided equally between them. He was advised by ICA, an agency. The FTT found that Mr Gray's activity had been in the nature of a trade.

As to commerciality, the FTT noted that there was no clear evidence that Mr Gray had had sufficient information to predict the financial results of his activity. Under the terms of the agreement with ICA, Mr Gray was committed to pay ICA's monthly fees; and in addition he agreed to pay, and did pay, for the promotional materials. The strategy in Mr Gray's plan for the future of his promotional activity was largely based on what ICA had recommended. In particular, no financial plans had been prepared. The FTT concluded that his approach had involved less of a degree of organisation and planning of his business (as opposed to the planning of the various steps in seeking to promote his wife's career) than would be appropriate or expected for a business of that nature.

Comments - HMRC argued that the taxpayer was sponsoring his wife and referred to the case of Murtagh in 2013. In *Murtagh*, the taxpayer claimed to be carrying on a trade of managing professional golfers, however, given that the only golfers supported by the taxpayer were his sons it was decided that the taxpayer was not trading, but instead supporting his sons' sporting ambitions. While the FTT noted that the facts of the cases were very different from those in this case, the FTT did find that the issue of motivation had some relevance to both the 'trade' issue and the 'commerciality' issue. Unlike in *Murtagh* the FTT found that in this case the taxpayer was trading.

S Gray v HMRC TC5151

Scheme to maximise double tax relief

Summary - The Court of Appeal found the taxpayer's claim under appeal, for Double Tax Relief with respect to Case V income, largely failed. No part of the first dividend received by the taxpayer could 'represent' the dividend paid subsequently by the UK subsidiary lower down in the chain; and all but AUS$820,000 of that dividend from the UK subsidiary had been applied in writing down the cost of investment in A&G, so only that residual amount could represent profits out of which the second dividend received by the taxpayer was paid.

Peninsular had implemented a scheme to maximise claims to DTR. FA 2000 had limited the amount of the foreign tax credit to the maximum amount of UK corporation tax via 'a mixer cap'. FA 2001 had then sought to mitigate the effects on multinational companies by allowing credit in a specific case; namely, for tax that would have been paid by the UK subsidiary of a foreign subsidiary, if the UK subsidiary had not been relieved from paying UK tax at the full rate, for example by using group relief. The purpose of the relevant provisions in FA 2001 concerned the UK subsidiary of a foreign subsidiary of a UK parent, which did not pay UK tax at the full rate. It sought to effectively put that UK subsidiary in the same position as the UK subsidiary of a UK parent company which paid a dividend to its UK parent. The payment of that dividend was not subject to UK corporation tax and the absence of DTR in that situation (deemed 'the Unfair Case') was unfair.

Peninsular, the UK ultimate parent in this case, contended that, under the legislation as amended, in the Unfair Case the amount of the credit (allowed in this case by unilateral DTR) was fixed mathematically. This was calculated by reference to the difference between the amount of foreign tax credit resulting from the mixer cap and the amount of underlying tax (foreign tax), which might be nil. HMRC countered with principally two propositions. First, the underlying tax must have been paid for DTR to be given (the tax borne argument). Second, the dividend paid by the UK subsidiary must flow through to the UK ultimate parent, i.e. be the source of profits for successive dividends up the chain to the UK ultimate parent, which had not happened in this case (the disappearing dividend argument).

Decision:

The Court of Appeal agreed with Peninsular on the tax borne argument but it also agreed with HMRC on the dividend disappearing argument. Therefore, it dismissed the appeal.

The court saw no reason why Parliament should not have decided to give a foreign tax credit where a non-resident company, A, makes a payment of dividend (out of profits distributed to it by a UK subsidiary) to a UK-resident company, B, in circumstances where the payment carries tax in the UK but would have carried no tax if company A had been in the UK; and to do so without requiring that company A or its subsidiary should have suffered tax locally. Additionally, Parliament may have provided for the credit to be reduced if the payment only reached the UK to some extent.

Comments - The Court of Appeal considered a scheme to boost claims to double tax credit relief (DTR) in the hands of a UK parent company on a dividend received from a non-resident subsidiary and originating from another UK resident company. It found that the scheme failed.

The principal focus of the Upper Tribunal had been the absence of any tax paid by A&G and therefore, in its view, the absence of any 'tax borne' for the purposes of the DTR provisions. The Court of Appeal rejected this conclusion, but nevertheless found for HMRC on the question of 'higher level dividends'. Having prevailed on the 'tax borne' argument, one can anticipate the taxpayer seeking to have a final go before the Supreme Court on 'higher level dividends', revolving as it does in part around the company law treatment.

Peninsular & Oriental Steam Navigation Company v HMRC EWCA

Reasonable care to comply with the CIS and reliance on accountants

Summary - The FTT allowed a taxpayer's appeal against HMRC's decision to refuse to relieve him of his obligation to account for Construction Industry Scheme (CIS) deductions. The FTT found that by employing a professionally qualified accountant the taxpayer had taken reasonable care to comply with his obligations under the CIS.

The taxpayer's business was within the definition of a construction operation for the purposes of the construction industry scheme. He failed to deduct tax from payments to subcontractors. After an investigation, HMRC said it would issue a determination under reg 13(2) of the Income Tax (Construction Industry Scheme) Regulations 2005. The taxpayer claimed relief under reg 9 on the basis that he had taken reasonable care to meet his obligations.

HMRC refused. The taxpayer appealed, saying it was unfair to collect tax from him rather than recover it from the workers he had employed. He had no knowledge of the tax system and was unaware that he was doing anything wrong. Further, he had appointed an adviser who had not told him about his obligations.

Decision:

The First-tier Tribunal noted that the taxpayer had a 'limited formal education' as well as a 'very limited understanding of tax and accounting matters'. Sensibly he had employed a qualified chartered accountant — as opposed, say, to a less well-qualified book-keeper — and it was reasonable that he would not have expected to have to check the accountant's knowledge.

The judge considered that the taxpayer had been entitled to rely on the adviser to draw his attention to any outstanding matters. Not having received any indication that he had further filing obligations under the construction industry scheme, there was no reason why he should have raised the question himself.

Quoting from the tribunal's decision in *Barrett* (TC4514), the judge said: 'The mere fact that something that could have been done has not been done does not of itself necessarily mean that an individual's conduct in failing to act in a particular way is to be regarded as unreasonable.'

The taxpayer had taken reasonable care to comply and satisfied the conditions for relief in reg 9.

The taxpayer's appeal was allowed.

Comments - Although reliance on a third party does not normally constitute a reasonable excuse for a taxpayer's failure to fulfil obligations, in this case the FTT found that, given the taxpayer's lack of knowledge about the CIS from the perspective of a contractor, his employment of a professionally qualified accountant (who did not give him any indication of any CIS obligation) amounted to him taking reasonable care to comply with his CIS obligations.
The case also highlights how important it is for tax advisers and accountants to have engagement letters with their clients setting out exactly what services they will and will not provide.

B Mabe v HMRC TC5098

Claim for sideways loss relief

Summary – The Tribunal found that no valid claim for sideways loss relief existed.

The taxpayer reported that he had begun a self-employed consultancy business in 2009-10. He was also a full-time employee of a bank. He claimed to offset losses from his self-employment against his employment income. HMRC enquired into his 2010-11 tax return. It disallowed the losses on the basis that the business was not commercial and imposed a penalty. The taxpayer appealed, saying he had incurred expenditure on renting an office, and the cost of his car, telephones, internet, accountancy and software.

Decision:

The First-tier Tribunal agreed with HMRC that there was insufficient evidence of rent paid on a serviced office. On motor expenses, the taxpayer had provided no proof to show that he had used his car for his business. The tribunal reached the same conclusion on all other expenses claimed, other than £2,000 accountancy charges. Given reported turnover of £5,175 for the business, no losses had arisen.

The expenditure included in the return constituted an inaccuracy leading to an understatement of tax. The tribunal considered this to be careless because the taxpayer's failure to keep detailed records of his business was a failure to take reasonable care.

The taxpayer's appeal was dismissed.

Comments – It is imperative there are detailed records to support the tax position adopted by a taxpayer. It was quite clear from the case that the taxpayer's calim regarding his self-employment and the losses was not substantiated and accordingly the conclusion by the Tribunal was not exactly unexpected.

S Qayyum v HMRC TC5060

Treatment of units in a fund

Summary - The FTT held that the purchase of an interest in the Landmark Building, Boston, Massachusetts, USA, via a collective investment fund, was an investment as HMRC argued and not trading stock arising from a purchase in the ordinary course of the business of a long-established property company. The decision was one of substance depending on the unique circumstances of the case.

The Company purchased units in a collective investment scheme, the Anglo Irish Federal Street UK Limited Partnership (the Fund), for a total price of $3m of which $1.5m was provided from cash reserves and $1.5m was borrowed for an initial period of just over one year. The Fund invested, via another partnership, in the Landmark Building which was located in the central business district of Boston, Massachusetts, USA. The issue to be decided was whether, as the taxpayer argued, the purchase was made in the ordinary course of the business of a long-established property company so as to become trading stock within the meaning of s163(1) CTA 2009 or, alternatively, whether the purchase was an investment. Mourne Properties challenged HMRC's decision that units in a fund were an investment and therefore should not be treated as part of the company's trading stock.

Decision:

The FTT first noted that the treatment of the purchase of the units in the company's accounts — as part of its stock and not as an investment — was not determinative. The company's trading stock at the time of the purchase had been wholly composed of property located in Northern Ireland which the company owned, and which it could sell, dispose of, or deal with entirely as it wished. By contrast, the company had no power to deal with the building owned by the fund, a skyscraper situated in Boston.
The FTT also noted that the description of the fund as a collective investment scheme pointed towards the conclusion that the units were an investment. Similarly, the fact that the company was to be locked in for a period of two or three years suggested that the units were not part of its trading stock. Finally, any profit made by the company was the product of its investment and not of any activity by the company.

Comments - On the overwhelming balance of evidence, the Tribunal had no hesitation in reaching its decision. This seems an entirely reasonable conclusion based on the unique circumstances of the case. In deciding whether the purchase of the units formed part of the company's trade, the FTT exhaustively reviewed the company's trade.

Mourne Properties v HMRC TC5033

The taxation of financial dealers and Tower MCashback revisited

Summary - The FTT found that the expenditure incurred by financial dealers in relation to tax positive partnerships was deductible. Additionally HMRC were able to raise a point mentioned in the cover letter of a closure notice.

The two appellants, both financial dealers in the Investec group, had participated in transactions with the purpose of exiting from leasing partnerships without being taxed on any receipts of rental income or balancing charge.

The appellants claimed that they should only be taxed on the net profits from their activities, deducting the costs of purchasing the partnership interests from the rentals or the sale proceeds of the rentals received whilst they were the relevant partners.

HMRC contended either that the relevant costs were non-deductible, or that the appellants should be taxed both on the net profits in their respective sole financial trades and also on the entire partnership profits attributable to each appellant.

The first issue was whether the appellants had been conducting two trades or just one trade when becoming partners in the various partnerships The second issue was whether the costs incurred by the appellants were of a revenue or capital nature.

As a procedural point, the appellants contended that the terms of the closure notices precluded HMRC from raising its fall-back argument, which was that the appellants should not be taxed only on theirnet profits.

Decision:

On the first issue the FTT found that the appellants had been conducting their own sole financial trades, and that they had participated (in in a technical and minor manner) in a separate trade in partnership. There were therefore two trades and not just one trade with two computations.

On the second issue the FTT found that the appellants' expenditure in acquiring partnership interests and contributing further capital to the partnerships had been revenue expenditure, made in order to further their short-term venture. This conclusion was reinforced by the fact that the two appellants were financial trading companies, periodically dealing in receivables and that both companies had conducted seven very similar operations. Furthermore, the expenditure had been incurred wholly and exclusively for the purpose of each of the sole trades of the appellants.

On the procedural point, the FTT noted that the machinery for issuing closure notices when enquiries were completed contemplated that HMRC should reach only one conclusion and make one adjustment to the figures to reflect its conclusion. The covering letter sent by HMRC with all the closure notices had made it clear that the closure notices themselves addressed only the 'capital' and 'non-deductible expense' point, but that the other points had not been abandoned. The FTT concluded that HMRC should be allowed to raise its fall-back argument.

Having concluded that all the costs of purchasing the partnership interests and contributing funds to the partnerships were deductible, the FTT had to decide how the calculations should be made. It found that in calculating the profits of the appellants' sole trades, it was appropriate to deduct from the gross income the amount already taxed under s114 ICTA 1988.

Comments – In its introduction to the decision which was 40 pages long the FTT stated that this 'was a very interesting and difficult case'. The closure notice point was different from the issue in *Tower MCashback* in 2010 as it was almost its 'mirror image'. The FTT decided that HMRC could raise a point in the cover letter if it was not possible to do so in the closure notice itself.

Investec Asset Finance and Investec Bank v HMRC TC5111

Foreign dividend income

Summary – The Court of Appeal confirmed in substance the decision in the High Court.

The taxpayer's argument that the UK rules on the taxation of dividends paid by non-resident companies to companies resident in the UK were a breach of Art 63 of the Treaty on the Functioning of the EU had been upheld by the Court of Justice of the EU (*Test Claimants in the FII Group Litigation v CIR* (Case C-446/04) . As a result, the taxpayer claimed the overpaid advance corporation tax.

HMRC appealed against the High Court decision in favour of the taxpayer.

Decision:

The Court of Appeal described Mr Justice Henderson's judgment in the High Court as 'a masterpiece of exposition and reasoning'. Lord Justice Lewison said: 'It contains a comprehensive analysis of all the issues canvassed before him. He now has more experience of the interaction between EU law and the interstices of the UK system of taxation than anyone else; and his views are entitled to great weight.'

Lord Justice Lewison upheld that decision, except on three technical issues relating to the computation of advance corporation tax.

HMRC's appeal was allowed in part.

Comments – The decision is self explanatory.

Prudential Assurance Co Ltd v CRC EWCA

Plant and machinery (Lectures B961/ B962 – 14.21 / 12.56 minutes)

The term 'plant and machinery' is not defined by statute, and its meaning has been developed over the year by court decisions, most recently in Executors of Lord Howard HMRC ([2014) EWCA Civ 278

Machinery takes its ordinary meaning, which is typically a device or assembly of interconnected fixed and movable parts, which transmits force to do useful work and often (but not always) has a power supply. HMRC accepts that the term 'machinery' includes machines and the workings of machines, which usually have moving parts. It also accepts that assets like motor vehicles and lathes are machines, as are computers and similar electronic devices, and other less obvious assets such as door handles with moving parts (CA 21010).

For expenditure incurred on or after 30 November 1993, the scope of the term 'plant and machinery' is further limited by ss21 and 22 .Nevertheless, apart from integral features and a small number of other types of expenditure specifically treated as plant by statute, the eligibility of individual assets will be decided either by established practice or by decided cases.

S21 CAA 2001 starts off by stating that expenditure on the provision of plant or machinery does not include expenditure on the provision of buildings.

There is then a list ('List A') of assets treated as buildings. S22 CAA 2002 repeats the process, indicating that expenditure on plant or machinery does not include expenditure on the provision of structures or other specified assets. List B then lists excluded structures and other assets.

List A: Assets treated as buildings

1. Walls, floors, ceilings, doors, gates, shutters, windows and stairs.

2. Mains services, and systems, for water, electricity and gas.

3. Waste disposal systems.

4. Sewerage and drainage systems.

5. Shafts or other structures in which lifts, hoists, escalators and moving walkways are installed.

6. Fire safety systems.

List B: Excluded structures and other assets

1. A tunnel, bridge, viaduct, aqueduct, embankment or cutting.

2. A way, hard standing (such as a pavement), road, railway, tramway, a park for vehicles or containers, or an airstrip or runway.

3. An inland navigation, including a canal or basin or a navigable river.

4. A dam, reservoir or barrage, including any sluices, gates, generators and other equipment associated with the dam, reservoir or barrage.

5. A dock, harbour, wharf, pier, marina or jetty or any other structure in or at which vessels may be kept, or merchandise or passengers may be shipped or unshipped.

6. A dike, sea wall, weir or drainage ditch.

7. Any structure not within items 1 to 6 other than—

   a) a structure (but not a building) within Chapter 2 of Part 3 (meaning of "industrial building"),

   b) a structure in use for the purposes of an undertaking for the extraction, production, processing or distribution of gas, and

   c) a structure in use for the purposes of a trade which consists in the provision of telecommunication, television or radio services.

S23 CAA 2001 then lists items which might fall within List A and B but which are excluded from the exemption, by virtue of particular legislation. These are:

- thermal insulation of industrial buildings (s28 CAA 2001)
- fire safety (s29 CAA 2001)
- safety at designated sports grounds (s30 CAA 2001)
- safety at regulated stands at sports grounds (s31 CAA 2001)
- safety at other sports grounds (s32 CAA 2001)
- personal security (s33 CAA 2001)
- software and rights to software (s71 CAA 2001)

S23 CAA 2001 also includes List C, which lists expenditure unaffected by s21 and s22. It should be noted that this does not automatically mean that capital allowances are available on those items, it just means that they are not specifically excluded. It is necessary to consider the Case Law to determine actual eligibility to capital allowances.

<u>List C: Expenditure unaffected by sections 21 and 22</u>

1. Machinery (including devices for providing motive power) not within any other item in this list.

2. Gas and sewerage systems provided mainly—

   (a) to meet the particular requirements of the qualifying activity, or

   (b) to serve particular plant or machinery used for the purposes of the qualifying activity.

3. [no category 3 exists as it was repealed in 2008]

4. Manufacturing or processing equipment; storage equipment (including cold rooms); display equipment; andcounters, checkouts and similar equipment.

5. Cookers, washing machines, dishwashers, refrigerators and similar equipment; washbasins, sinks, baths, showers, sanitary ware and similar equipment; and furniture and furnishings.

6. Hoists

7. Sound insulation provided mainly to meet the particular requirements of the qualifying activity.

8. Computer, telecommunication and surveillance systems (including their wiring or other links).

9. Refrigeration or cooling equipment.

10. Fire alarm systems; sprinkler and other equipment for extinguishing or containing fires.

11. Burglar alarm systems.

12. Strong rooms in bank or building society premises; safes.

13. Partition walls, where moveable and intended to be moved in the course of the qualifying activity.

14. Decorative assets provided for the enjoyment of the public in hotel, restaurant or similar trades.

15. Advertising hoardings; signs, displays and similar assets.

16. Swimming pools (including diving boards, slides and structures on which such boards or slides are mounted).

17. Any glasshouse constructed so that the required environment (namely, air, heat, light, irrigation and temperature) for the growing of plants is provided automatically by means of devices forming an integral part of its structure.

18. Cold stores.

19. Caravans provided mainly for holiday lettings.

20. Buildings provided for testing aircraft engines run within the buildings.

21. Moveable buildings intended to be moved in the course of the qualifying activity.

22. The alteration of land for the purpose only of installing plant or machinery.

23. The provision of dry docks.

24.. The provision of any jetty or similar structure provided mainly to carry plant or machinery.

25. The provision of pipelines or underground ducts or tunnels with a primary purpose of carrying utility conduits.

26. The provision of towers to support floodlights.

27. The provision of—

(a) any reservoir incorporated into a water treatment works, or

(b) any service reservoir of treated water for supply within any housing estate or other particular locality.

28. The provision of—

(a) silos provided for temporary storage, or

(b) storage tanks.

29. The provision of slurry pits or silage clamps.

30. The provision of fish tanks or fish ponds.

31. The provision of rails, sleepers and ballast for a railway or tramway.

32. The provision of structures and other assets for providing the setting for any ride at an amusement park or exhibition.

33. The provision of fixed zoo cages.

Date of expenditure

Capital allowances are first given for the chargeable period in which capital expenditure has been (or is deemed to have been) incurred. When the rate of an allowance is changed the new rate is effective in respect of capital expenditure incurred on or after a specified date. It is clear, therefore, that the ascertainment of that date is very important

For the purposes of claiming allowances, the general rule is capital expenditure is incurred on the date on which the obligation to pay becomes unconditional, even if there is a later payment date (s 5(1)). Delivery of the goods is normally the time when the obligation to pay becomes unconditional.

Payment within one month after accounting date

For works under contract, capital expenditure is incurred on the issue of a certificate of work to date. If a certificate is issued within one month of the end of the accounting period but the asset has become the company's property before the end of the accounting period, the expenditure is deemed to have been incurred on the last day of the accounting period concerned (s 5(4)).

This subsection recognises the fact that extended contracts (frequently called 'milestone contracts') usually provide for monthly payments or other periodical payments based on valuations of work done. If the work done before a yearend (and therefore attributable to the purchaser) is not certified (which is generally when the obligation to pay becomes unconditional) until after the year end, this subsection treats the obligation to pay as having become unconditional before that year end.

Payment after four months

If the contractual payment period is longer than four months the expenditure is treated as incurred on the payment due date (s 5(5)).

It follows that if an asset is unconditionally purchased with a four-month credit period, allowances will be available for the period in which it is purchased. However, if the credit period is longer than four months, the period in which allowances become available is determined as if the expenditure has been incurred on the last day of the credit period. In either case the actual date of payment is irrelevant.

Consequently, if a credit period of three months is allowed, but actual credit of five months is taken, the 'four-months' rule' of s 5(5) has no effect.

Capital expenditure incurred before a trade begins

Capital expenditure incurred on plant and machinery for the purposes of a qualifying activity, by a business about to carry on the activity, is treated as if it had been incurred on the first day on which the business carries on the activity (s12)

Where a business brings plant or machinery into use for the purposes of a qualifying activity but already owns the plant or machinery because it had acquired it for another purpose, it is treated as incurring expenditure of an amount equal to the lesser of cost and market value at the date on which the change of use occurs (s13).

Retentions

HMRC's view is that the obligation to pay any part of the purchase price that is the subject of a retention does not become unconditional until the condition which gave rise to the retention is satisfied, for example the end of the defects liability period (CA11800). The same principles will apply where money is paid into an escrow account, pending the satisfaction of any conditions.

Hire purchase contracts

Capital expenditure still to be incurred under a hire purchase contract at the time when the asset is brought into use is treated as incurred on the date on which the asset is brought into use (CA11800)

Irrecoverable VAT

If the business incurring the capital expenditure is not registered for VAT and therefore ineligible to claim relief for input VAT, any VAT paid on the cost of the asset is taken into account when calculating the allowances. If the business is partially exempt and only part of the input VAT is relieved, the VAT not so relieved is taken into account when calculating the allowances.

If an additional VAT liability is incurred or an additional VAT rebate arises, for example under the operation of the VAT capital goods scheme, this is treated as an adjustment to the capital expenditure, taking place on the last day of the relevant VAT interval (CA11800)

Timing of claims

A business can select the amount of capital allowances to claim in an accounting period and thus influence both the immediate exposure to tax and the allowances available in subsequent accounting periods.

It need not claim the full amount of capital allowances available, choosing instead either to make a reduced claim or not to claim at all, e.g. if it wishes to maximise a loss in a future accounting period. For a company the claim must be made within the normal self-assessment corporation tax return time limits, being two years after the end of the accounting period concerned (Sch 18, para 82 FA 1998).

The normal time limit is extended in circumstances where there is an enquiry, amendment or appeal, to 30 days after the respective closure notice, amendment or determination.

HMRC have the power to extend the statutory time limits in exceptional circumstances, but have stated that they will not extend the time limits in respect of the following (CA11140):

- a change of mind.
- hindsight showing that a different combination of claims might be advantageous.
- oversight or error, whether on the part of the company or its tax agent.
- absence or indisposition of an officer or employee of the company unless the absence or illness arose at a critical time, which delayed the making of the claim.

Annual investment allowance (AIA)

Expenditure incurred on plant and machinery, but not cars, qualifies for AIA (s 38B).

AIA is given for a chargeable period, which in the case of a company is its accounting period (s6 (1)). If the accounting period is shorter than 12 months, the maximum AIA is reduced proportionately (s 51A (6)). A company may claim all or part of the AIA to which it is entitled (s 51A (7)).

Maximum AIA limits

Maximum AIA limits since inception have been:

	£
1 April 2008 to 31 March 2010	50,000
1 April 2010 to 31 March 2012	100,000
1 April 2012 to 31 December 2012	25,000
1 January 2013 to 31 March 2014	250,000
1 April 2014 to 31 December 2015	500,000
1 January 2016 onwards	200,000

The maximum AIA had been expected to fall to £25,000 from 1 January 2016, until the government announced an increase in the permanent level of the AIA to £200,000 from that date and committed to maintaining it at this level throughout the current Parliament.

On the reduction in AIA from £500,000 to £200,000 on 1 January 2016, the transitional provisions that apply are unchanged from those that were to have applied on the AIA reducing to £25,000 (Sch 2, paras 4–5 FA 2014; s 8 FA (2) 2015).

Where an accounting period straddles 1 January 2016, the maximum AIA claim is apportioned pro rata. The maximum AIA for the whole of the period is the sum of each maximum AIA that would be found if each of the component periods (i.e. the parts before, and on or after, 1 January 2016) were treated as separate chargeable periods).

However, it is then necessary to consider the second of those periods separately.

In relation to expenditure incurred in the part of the second straddling period falling on or after 1 January 2016, maximum AIA for that part is limited to the amount that would have been the maximum allowance if it were treated as a separate chargeable period. In other words, for expenditure incurred on or after 1 January 2016, only expenditure up to the pro-rated amount of the new £200,000 cap can be covered.

This replicates the provisions that applied when AIA was reduced from £100,000 to £25,000 on 1 April 2012 (s11 FA 2011).

Example: AIA straddling 1 January 2016

Baldock Ltd is a trading company which prepares its accounts to 31 May annually. During the year to 31 May 2016, it purchases the following items of plant:

Date	Equipment	Cost (£)
10 October 2015	Packaging machine	80,000
1 April 2016	Assembly conveyor	400,000

First, it is necessary to calculate the maximum AIA for the period as a whole.

On a straight apportionment basis, the maximum allowance for the part of the period that falls before 1 January 2016 (in this case, the period from 1 June 2015 to 31 December 2015) is: £500,000 × 7/12 = £291,667

On the same basis, the maximum allowance for the part of the period that falls on or after 1 January 2016 (in this case, the period from 1 January 2016 to 31 May 2016) is: £200,000 × 5/12 = £83,333

Thus, the company's maximum AIA for the whole of this period is: £291,667 + £83,333 = £375,000

Actual expenditure incurred in the part of the second straddling period that falls on or after 1 January 2016 is £400,000, which is more than the maximum of £83,333 for that period, so AIA of up to only £83,333 may be claimed.

AIA may therefore be claimed in full on expenditure of (£80,000 + £83,333) £163,333

The timing of expenditure will have an impact on the availability of AIA.

Mixed partnerships

Although AIA may be claimed by an individual, a partnership or LLP in which all the members are individuals, or a company, it may not be claimed by a mixed partnership or LLP of which a company is a member (s 38A (3); see Hoardweel Farm Partnership v HMRC (2012) TC 402 and Drilling Global Consultant LLP v HMRC (2014) TC 04003.

Allocation of AIA

Planning the timing of capital expenditure, and optimising the allocation of AIA to qualifying expenditure, may both play a part in maximising capital allowances.

Regardless of the number of activities that a business carries on, it may only claim one AIA. It may claim all the AIA to which it is entitled, or it may choose to claim only part of that amount (s 51A (7)).

A business may allocate its AIA to its relevant qualifying expenditure as it thinks fit (s51B). This can be crucial in maximising capital allowances because, by allocating the AIA first to expenditure that does not qualify for FYA, the business may still be entitled to some FYA in the same year.

Example: Allocation of AIA

Mellor Ltd carries on a manufacturing trade and also runs a commercial property rental business. During the 12-month accounting period to 31 March 2015, the company's manufacturing division spent £500,000 on new plant and machinery which would qualify for 18% main rate writing down allowance, while the letting business spent £100,000 on plant and machinery which would qualify for 8% special rate writing down allowance.

The company claims annual investment allowance of £500,000, the maximum for the accounting period, and decides to allocate its AIA as follows:

Eligible for AIA	£	Allocation of AIA	£
Expenditure incurred re			
Manufacturing trade	500,000	Manufacturing trade	400,000
Rental business	100,000	Rental business	100,000
Total claim			500,000

As a result, the balance of £100,000 of expenditure that is not covered by AIA will qualify for ongoing writing down allowances of 18% rather than 8%.

Related businesses

A single company is entitled to only one AIA - even if it carries on more than one qualifying activity. For example, a company that carries on a trade as well as a property business may have two qualifying activities, but only one AIA, although that AIA may be shared between the two activities in any way the company sees fit.

Other 'related' companies under common control - are entitled to a single AIA to be allocated between them in any way they see fit.

Companies are related to one another (s51G and s51J) if, during a financial year, either they share the same premises, or they derive more than 50% of their respective turnovers from qualifying activities within the same NACE common statistical classification.

The NACE classification is the first level of the common statistical classification of economic activities in the European Union, established by Regulation (EC) No 1893/2006 of the European Parliament and the Council of 20 December 2006.

A company is controlled by a person in a financial year if that person controls it at the end of its accounting period ending in that financial year (s 51F). 'Control' means that a person has the power to determine that a company's affairs are conducted in accordance with his wishes (s574 (2)).

Example AIA: companies under common control

Ward Ltd runs a retail shop. Rollings Ltd operates as an insurance broker. Both are controlled by Mr Horton. Ward Ltd has an accounting period ending on 30 April 2014. It had sole occupation of Ward House, its business premises. On 1 July 2014, Rollings Ltd, with an accounting period ending on 31 December 2014, moved into Ward House. Both companies occupied the premises until 31 December 2014.

The companies meet the shared premises condition from 1 July to 31 December 2014, and are therefore related to one another during the financial year 2014.

Short life assets

The short life assets (SLA) regime in Part 2 Ch 9 (s 83 to s 89) enables businesses to allocate expenditure on specific assets into their own single asset pools.

SLA pools are designed to enable businesses to accelerate capital allowances on assets expected to have a useful life of up to eight years.

Relief is obtained through assets being maintained in their own SLA pool, enabling the business to claim balancing allowances on their disposal. This is instead of the acquisition costs and disposal proceeds being taken into account in calculating writing down allowances on an ongoing basis.

Assets

In general, the assets that will benefit from the SLA regime are those which, normally, would fall within the main plant and machinery pool but which have a useful life of up to eight years. Non-qualifying assets include cars and those with an element of personal use outside the business. See s84.

In reality, most businesses should have some assets that would benefit from being allocated to a SLA pool. For example, IT equipment rarely reaches an age of more than eight years before it is scrapped. Other common examples include office furniture and general equipment.

Administration

An election to have an asset treated as a short life asset:

- must be made in writing to HMRC
- must specify the short life asset together with cost and acquisition date
- must be made within two years of the end of the chargeable period (corporation tax) or by the first anniversary of 31 January after the end of the tax year (income tax) in which the expenditure was incurred on the asset
- is irrevocable (so do not elect if a balancing charge is likely!).

Consider Stockdale who buys a computer in his accounting period ended 31 July 2016. If he wants to make a short life asset election he must do it by 31 January 2019. In the majority of cases this would be done when submitting the 2016/17 self assessment return which will be on or before 31 January 2018.

The election

The format of the election is not specified by HMRC. Provided the required information is communicated to HMRC then the election will be made. There is no need to obtain HMRC approval provided the details are made clear.

Strictly, an election for short life asset treatment should specify each asset it covers together with its cost. This is easily done via the tax computation where only the occasional asset is subject to a short life asset election.

If separate identification of short life assets acquired in a chargeable period is impossible or impracticable, then HMRC will accept an election that gives information on the assets by reference to batches of acquisitions, with their costs aggregated and shown in one amount provided the claimant can satisfy HMRC that:

- the assets are not specifically excluded, and
- the election gives enough information for it to be clear what is and what is not covered by it.

Strictly, each short life asset should go into its own pool so that the allowances on it are calculated separately. This may not be practicable where assets are held in large numbers. In such cases, capital allowance computations which give the correct statutory result, and which do not abuse the short life asset provisions, should be accepted even if there is not a separate computation for each asset.

HMRC Example (CA23640)

Alice runs a restaurant and, every year, buys glassware. She agrees with HMRC that these have an actual life of three years and that nothing is received for the remains.

She has used her AIA annual amount on other expenditure. She spends £1,200 in the year ended 30 June 2010 and makes a short life asset election. She can make a single calculation for that expenditure of £1,200 and claim a balancing allowance for the year ended 30 June 2013 based on a disposal value of nil. None of the glasses bought in the year ended 30 June 2010 should still exist by then because they have an actual life of 3 years and Alice will not have received anything for them.

Integral features

With effect from 1 April 2008 (corporation tax) or 6 April 2008 (income tax), there is a separate special rate pool for integral features for which a WDA of 8% pa is given. The integral features included in this pool are:

- electrical systems (including lighting systems)
- cold water systems
- space or water heating systems (i.e. heating and hot water), powered systems of ventilation, air cooling or air purification and air conditioning), and any floor or ceiling comprised in such a system
- lifts, escalators and moving walkways; and
- external solar shading (i.e. brise soleil).

The legislation does not define a 'system' and HMRC has published guidance clarifying its understanding of what is meant by this. In its view:

- an electrical system is a system for taking electrical power (including lighting) from entry to the building or structure, and distributing it through the building or structure, as required. It does not include systems intended for other purposes (e.g. communication and surveillance systems, or alarm systems)
- a cold water system is one for taking water from the entry point to the building or structure and distributing it as required, which again may range from the very simplest to the most complex; A 22330
- a powered system of ventilation would include, for example, a radon sump with extractor fan.

The replacement rule

The above rules apply where expenditure is on the provision or replacement of an integral feature. The term ‘replacement’ is also extended by s33B under which, if expenditure on an integral feature (e.g. repairs) is more than 50% of replacement cost, that expenditure will be treated as being in respect of a replacement.

Repairs costing 50% of the cost of replacing a heating system could be allowed as repairs, but if that figure were 50.1% they would automatically be treated as capital. It is not easily possible to circumvent the 50% rule by fragmenting repair expenditure, as the calculation must be based on the cumulative total of expenditure incurred over a rolling 12-month period.

So, in determining whether the repairs have cost more than 50% of the cost of replacing the entire asset, one must consider the cumulative expenditure incurred over a running 12-month period. A business cannot automatically avoid expenditure being treated as capital simply by incurring it in several instalments, even if they fall into different accounting periods.

Example (CA 22350 - adopted)

Cole designs, makes and sells jewellery. He incurs expenditure on repairing or replacing parts of the central heating system in his large studio/shop. The expenditure he incurs on the system is as follows:

Date	Repair Cost	12m cumulative expenditure	Replacement cost	% of original replacement	50% exceeded?
1.4.14	£10k	£10k	£60k	16.6%	No
1.9.14	£20k	£30k	£60k	50%	No
1.12.14	£5k	£35k	£65k	53.8%	Yes

Long life assets

Long life assets are assets with a predicted useful life of at least 25 years. Typically this will apply to very specific trades such as large manufacturing trades, power stations, aircraft and shipbuilding etc where some assets can be expected to be used in the business for a very long time. Green technology is often regarded as a long life asset e.g. Solar PV Panels.

Where an asset is a long life asset, it is mandatory to treat it as such. It is not a claim. This means that it is very important to consider whether the client has any long life assets, by asking them and / or looking at the depreciation policy in the financial statements. If an asset is written down over 25 years or more in the accounts, this is not a guarantee that it is a long life asset, however it may alert the Inspector to its existence and prompt him to open an enquiry.

Like integral features, long life assets are taken to the special rate pool and are given writing down allowances at 8% (10% prior to April 2012) on a reducing balance basis.

However, items are not treated as a long-life assets where total expenditure in the accounting period on such assets does not exceed £100,000.

If a sole trader or company buys assets with an expected useful life of over 25 years, but the expenditure on such assets in the period is less than £100,000, the asset is treated as a standard piece of plant and machinery and normal writing down allowances are available at a rate of 18%.

This £100,000 limit is adjusted for short or long accounting periods. For example, if a trader draws accounts for a six-month accounting period, the long life asset limit would be £50,000. For a group of companies, the £100,000 limit is adjusted for the number of associated companies.

If an asset is acquired second hand and had originally received a 18% (or 20%) writing down allowance, the new owner will continue to obtain relief at 18%. The test of a long life asset is whether the asset could reasonably have been expected when new to have a useful economic life of at least 25 years. The fact that a subsequent buyer plans to use the asset beyond that 25 year span does not alter the treatment.

If an asset has been treated as a long life asset by a seller, the buyer will also have to treat the asset as a long life asset, regardless of how much he buys the asset for.

The AIA is available on long life assets.

Capital allowances on cars

The 100% first year allowance (FYA) for low emission cars will be extended for a further three years to April 2021. The carbon dioxide emission threshold below which cars qualify for the 100% FYA will be reduced from 75 grams / kilometre to 50 grams / kilometre from April 2018.

The carbon dioxide emission threshold for the main rate of capital allowances for business cars will also be reduced from April 2018 from 130 grams / kilometre to 110 grams / kilometre. The legislation in this area to apply from 2021 will be reviewed again at Budget 2019.

What is a car?

It will be obvious in most cases but there are some issues. A car is defined as a mechanically propelled road vehicle other than

- a motorcycle (not including quad bikes as these have four wheels)
- a vehicle of a construction primarily suited for the conveyance of goods or burden of any description
- a vehicle of a type not commonly used as a private vehicle and unsuitable for such use

Some observations from the HMRC guidance on cars can be made.

- The second point above refers to the construction of a vehicle and not with the way it is used. The fact that the manufacturer might describe a vehicle as a commercial vehicle is not going to be conclusive. Modifications might be taken into account as long as they are permanent.

- The third point above refers to vehicles not commonly used as private vehicles and unsuitable for such use. This would include vehicles with fixed flashing lights, dual controls, rooftop signs or loud speakers.

- A motorhome is a car, as confirmed by the Courts

- Taxis are cars unless they are London black cabs ie Hackney carriages

- Offroad cars will typically be cars (with one or two potential exceptions) as will double cab pickups with a payload under 1 tonne.

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

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

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

Energy saving plant or machinery

A first-year plant and machinery allowance is available at a rate of 100% for expenditure on qualifying 'new energy-saving plant or machinery'.

Qualifying energy-saving plant / machinery

To qualify, the asset acquired must:

- be eligible for plant and machinery capital allowances under the general rules

- not be caught by the general exclusions applicable to first-year qualifying expenditure

- be new and unused plant or machinery

- be of a description specified by Treasury Order

- meet the energy-saving criteria specified by Treasury Order for plant / machinery of that description

CAA 2001, s 45A refers to plant / machinery of a 'description' and meeting criteria, both specified by Treasury Order. In practice, the Treasury Order SI 2001/2541 gives statutory authority to two lists issued by DEFRA:

- the Energy Technology Criteria List
- the Energy Technology Product List

Both lists are maintained on the GOV.UK website.

The Energy Technology Criteria List sets out classes of qualifying technology (as at July 2015):

1) air-to-air energy recovery equipment

2) automatic monitoring and targeting equipment

3) boiler equipment

4) combined heat and power

5) compressed air equipment

6) heat pumps

7) heating, ventilation and air-conditioning equipment

8) high speed hand air dryers

9) lighting

10) motors and drives

11) pipework insulation

12) radiant and warm air heaters

13) refrigeration equipment

14) solar thermal systems

15) uninterruptible power supplies

16) waste heat to electricity conversion equipment

The Energy Technology Product List sets out specific products (defined by manufacturer and model) for classes 5–14 in the list above, specifying those products which meet the criteria where the manufacturer has applied for listing.

Products which meet the description and criteria but are not included on the Product List do not qualify for FYAs, despite meeting the apparent requirements of the legislation, because the Treasury Order adds the requirement that the product be listed. A manufacturer of a qualifying product should seek listing, as the FYA will make the product more attractive to potential purchasers.

However, it is considered that there are too many products in certain classes for a comprehensive list to be practical and so the products in these categories must meet the following requirements:

- combined heat / power: must be certified by the Secretary of State as qualifying, and have a Combined Heat and Power Quality Assurance Certificate. This must be renewed annually.
- component-based systems of automatic monitoring / targeting: any component in this class must be certified by the Secretary of State as qualifying
- pipework insulation: must meet specific British Standards
- lighting: must meet the relevant technology criteria for each sub-technology

The criteria and descriptions change from time to time as technology becomes more energy-efficient.

For example, compact heat exchangers were removed from the Energy Technology Criteria List with effect from 3 August 2010 and uninterruptible power supplies became eligible for ECAs with effect from 4 August 2009.

<u>Certificates of energy efficiency</u>

Where a certificate of energy efficiency is required, it must remain current throughout the use of the asset for the claimed FYA to be valid.

Where a certificate is revoked, it is treated as never having existed and so the claimant company's tax return must be amended. The company must notify HMRC within three months of revocation, specifying how the return will be amended. Failure to notify HMRC in time may result in a penalty in accordance with TMA 1970, s 98.

Where the certificate has been obtained by the manufacturer, or some person other than the company claiming the FYA, it is a good idea to seek indemnities at the time of purchase requiring the vendor to notify the purchaser in good time if the certificate is revoked, in order to enable the purchaser to notify HMRC.

<u>Components</u>

The entire asset does not need to qualify for FYAs. A claim can be made where one or more components of a plant or machinery asset qualify as energy-saving.

Where a claim is made for FYAs for a component, the amount on which an FYA can be claimed is specified in the Energy Technology Product List. Where more than one component is eligible, the aggregate of the amounts specified in the list will qualify for FYAs. Note that the 'just and reasonable apportionment' provisions do not apply to claims for FYAs in respect of components.

Repayable credit

The company can claim a credit in the form of a tax repayment on qualifying expenditure by surrendering a qualifying loss, which is restricted to the lower of the first year allowance and the unrelieved loss. Various conditions apply, as detailed below. Of particular note is the meaning of an unrelieved loss.

Relevant first-year expenditure is that incurred on or before 31 March 2018 on energy-saving plant or machinery (CAA 2001, s 45A) or environmentally beneficial plant or machinery (CAA 2001, s 45H).

First-year tax credit claimed reduces the amount of the loss carried forward (Sch A1 para 19 CAA 2001).

Amount of first-year tax credit

If a company has a surrenderable loss for the accounting period, it is entitled to claim a first-year tax credit of the lower of:

- 19% of the amount of the surrenderable loss for the accounting period; and
- the upper limit (CAA 2001, Sch A1, para 2(1)).

The upper limit is the greater of:

- PAYE and NICs liabilities for the accounting period; and
- £250,000 (CAA 2001, Sch A1, para 2(2))

A company may claim the whole or part of the amount to which it is entitled.

Example-calculation of first-year tax credit

In the year to 31 March 2015, Rosenoir Limited invests in a solar-powered energy system qualifying for a first year allowance of £100,000. The company has traded at a loss, but its prospects have now improved. It has PAYE and NIC liabilities for the year of £18,000. It is considering surrendering its loss for the year ended 31 March 2015 in return for a first-year tax credit. Its results are as follows.

	£
Trade loss	(500,000)
Property income	80,000
Loan interest	5,000
First year allowance	100,000

There were no profits for the year ended 31 March 2014.

The surrenderable loss for the year ended 31 March 2015 is calculated as follows:

	£
Loss for year	500,000
Less relief against profits of the same accounting period	
Property income	(80,000)
Loan interest	(5,000)
Maximum surrenderable loss	415,000
Tax credit based on first year allowance	100,000

The tax credit is restricted to the lower of:

- 19% of the first year allowance
- the greater of total PAYE/ NIC for the year and £250,000

The company claims a tax credit of £19,000

Loss carried forward	315,000

Before surrendering its loss, the company should compare the effect of this with the alternative of carrying forward the whole of its loss against future profits.

Circumstances in which first-year tax credit clawed back

The first-year tax credit is clawed back if the equipment on which it is claimed is disposed of within four years after the end of the accounting period for which the tax credit was paid. In this case, the loss is restored and the first-year tax credit treated as if never paid (Sch A1, para 24 CAA 2001).

The disposal value of the item is the amount received, but this is replaced by market value if the disposal is made to a connected person for below market value, or the business is in new ownership (Sch A1, para 25 CAA 2001).

Tax credit claim

A tax credit claim must be included in the corporation tax return. The following details must be given (Sch 18, para 83ZA (1) FA 1998):

- the plant or machinery on which the claim is made;
- the relevant first-year expenditure incurred; and
- the date on which that expenditure was incurred.

The company must also provide a certificate, as applicable, for energy-saving plant and machinery (s45B CAA 2001) or environmentally beneficial plant and machinery (s45I CAA 2001).

A claim is to be disregarded if arrangements are entered into wholly or mainly for a disqualifying purpose, i.e. if the main object is to obtain a first-year tax credit to which the company would not otherwise be entitled, or of a greater amount than that to which it would otherwise be entitled (Sch A1, para 28 CAA 2001).

For details of categories of qualifying expenditure, go to www.gov.uk/guidance/energy-technology-list

A 100% enhanced allowance is also available on designated plant and machinery which meets strict water saving or efficiency criteria (eg meters, monitoring equipment, flow controllers, leakage detection, efficient toilets and taps.

Expenditure on Solar Panels

Expenditure on solar panels are to be treated as special rate expenditure i.e. allocated to the special rate pool on which capital allowances will be claimed at 8% WDA per annum. The taxpayer will still be able to claim the AIA against such expenditure.

Plant & machinery allowances of 18% WDA per annum can be claimed on other heat/ electrical generating assets provided it is not a long life asset i.e. life under 25 years.

Capital allowances on other aspects of the renewable installation will be subject to the usual rules. If the asset does meet the definition of long life assets, expenditure is subject to 8% WDA. The AIA can still be claimed on assets on which the tariff is received.

Enhanced Capital Allowances (ECAs) will not be available on assets on which the tariffs have been paid under either the Feed in Tariff or Renewable Heat Incentive schemes. However, the taxpayer is going to have the option, they either claim ECAs or the tariff. If they claim ECAs and subsequently receive a tariff payment then the ECAs will be clawed back.

For Combined Heat & Power installations the ECAs change will take effect from April 2014.

Income received in non-monetary form (Lecture B964 – 7.29 minutes)

The decision in *Gold Coast Selection Trust Ltd v Humphrey (1948)* is the leading case on the treatment of valuable non-monetary assets which are received in the course of a trade. The House of Lords held that the 'money value' of the non-monetary assets in question (shares) had to be credited to the company's profit and loss account for tax purposes.

Given that the position has been clearly established for the last 68 years, it is more than a little surprising to discover that Cl 67 FB 2016 contains a provision specifically seeking to enact this rule for transactions entered into on or after 16 March 2016.

New S28A ITTOIA 2005 provides that, where income is received in a non-monetary form as part of a trading transaction, the full monetary value of the relevant asset must be brought into account when computing the profits of the trade. There is a similar rule for property businesses.

The corporate equivalent of this measure is set out in new S49A CTA 2009.

Further confirmation can be found in Para BIM40051 of HMRC's Business Income Manual which indicates that a non-monetary receipt is taxable as part of the trading profits of a business if it is capable of being turned into money. Why, then, do we need Cl 67 FB 2016?

It is important to emphasise that, where a trader receives a benefit which is *not* convertible into money (eg. the provision of a non-transferable holiday as a reward for being a good customer of a particular supplier), such a benefit does not represent money or money's worth and so does not have to be brought into account as a trading receipt. Cl 67 FB 2016 does not affect this principle.

Contributed by Robert Jamieson

VAT

Requirement to obtain prior permission for the option to tax

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

In March 2004, the trustee of a self-invested personal pension (SIPP) bought a property which it leased to two dentists to run their practice. In August 2010, the trustee belatedly notified HMRC that it had opted to tax the property from 14 April 2004. The date was amended to 30 March 2004 and the department accepted the late notification.

In December 2011, the trustee sold the property to the taxpayers. They argued that the option to tax was invalid because the trustee had not obtained prior permission (para 3(9) Sch 10 VATA 1994) from HMRC before it could be exercised.

The First-tier Tribunal found for HMRC, so the taxpayers appealed to the Upper Tribunal.

Decision:

The Upper Tribunal said that the purpose of para 3(9) was that it should apply to exempt supplies made or intended to be made before the election took effect. In this case, the election was intended to have effect from 30 March 2004 and the grant of the lease to the dentists took place on the next day. It followed, therefore, that prior permission was not required.

The taxpayers' appeal was dismissed.

Comments - The appellants lost the appeal on both points.

Hills and another v CRC, Upper Tribunal

Suitability of invoices to claim input tax

Summary – The First-tier Tribunal held that the invoices were invalid because they did not contain the particulars required by reg 14.

The taxpayer claimed input tax on invoices received from a subcontract building company (S) between June 2012 and January 2013. S deregistered from VAT on 30 September 2012, so HMRC disallowed all input tax claims after this date. The department said also the invoices did not satisfy the requirements of reg 14 of the VAT Regulations [SI 1995/2518].

The taxpayer appealed on the basis that the directors had no knowledge of the deregistration. The company had paid the VAT element of all the invoices in good faith to the supplier. Further, the invoices immediately before and after the date of S's deregistration were identical in terms of the information supplied, yet HMRC repaid the VAT on the former.

Decision:

The First-tier Tribunal said the invoices were invalid because they did not contain the particulars required by reg 14. The description on the invoices 'labour and trade supplied at the following various sites' was insufficient to identify the goods or services supplied.

The tribunal decided HMRC had acted reasonably. No weight could be given to prior conduct of the department in accepting invoices that were non-compliant.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, commented: 'It was strange that HMRC said that the relevant factor was the narrative on the supplier invoices being inadequate rather than the fact that the company had issued invoices and charged VAT after its deregistration date. It allowed claims before October 2012 when the narrative on the invoices was exactly the same, so this appears to be inconsistent. The key message is for a business to ensure that all suppliers' invoices clearly show the nature of goods or services that have been supplied to avoid a potential problem on a compliance visit.'

Gradon Construction Ltd v HMRC TC4935

Eligible body for the purposes of exempt supplies of education

Summary - The Upper Tribunal (UT) has set aside the decision of the FTT finding that the relationship between SAE Education Ltd and Middlesex University fell short of constituting a 'college … of' MU within the meaning of the VATA 1994. Accordingly, it was not an 'eligible body' and its supplies of education were not eligible for exemption.

SAE Education Ltd argued that it made exempt supplies of education under item 1 note (1)(b) Group 6 Sch 9 VATA 1994. This was on the basis that it was a college of Middlesex University. HMRC said SAE was not an eligible body and that the supplies should therefore be standard rated.

The First-tier Tribunal found for the taxpayer, concluding that SAE was a college of Middlesex University.

HMRC appealed, saying the tribunal had erred in its findings of facts.

Decision:

The Upper Tribunal referred to *Pendragon plc v CRC* in 2015 as authority giving it the power to interfere with the findings of fact made by the First-tier Tribunal as long as that tribunal had made 'errors of approach' in its decision. In this case, the Upper Tribunal found that the First-tier Tribunal had made such errors and it was appropriate to intervene.

The judge said the First-tier Tribunal had not properly evaluated the university's relationship with SAE. The university and SAE had a close working relationship, but it was clear that the former did not regard SAE as a college. Instead it considered SAE to be an independent institution with which it had collaborative arrangements.

The taxpayer was not an eligible body. HMRC's appeal was allowed.

Comments - The UT found that the FTT had erred. However it stated that the FTT's task had been made difficult by sparse documentary evidence and by the fact that no representative of MU had given evidence.

CRC v SAE Education Ltd, Upper Tribunal

Application for exception from VAT registration

Summary – The FTT dismissed the appeal against HMRC's decision that Renforth should be registered for VAT and against HMRC's refusal of the application to be excepted from registration.

The taxpayer traded as a builder. His income exceeded the VAT registration limit on 28 February 2013 so he should have registered from 1 April 2013. However, his liability was established only when his accountant prepared his 2012-13 self-assessment tax return in January 2014. The taxpayer asked HMRC for an exception to being registered on the basis that turnover in the 12-month period after February 2013 was less than the deregistration threshold. HMRC refused. The taxpayer appealed.

Decision:

The First-tier Tribunal noted that the taxpayer quoted actual turnover figures to HMRC whereas the decision to grant an exception was based on foresight of likely turnover. Therefore actual turnover had 'no direct relevance on the reasonableness of a decision based on foresight'. HMRC had to make a decision according to what was ascertainable in February 2013, not February 2014 when the application was made.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, commented: 'The problem for the taxpayer was that he was part way through a long-term contract at the end of February 2013, with no apparent indication when it would be completed. So a request for an exception on that date would have been difficult to justify. The case highlights another reason why a non-registered business owner trading close to the VAT threshold should not wait until the following January to have his accounts and self-assessment tax return done by his accountant.'

K Renforth trading as Façade Detailing Service v HMRC TC5021

Reasonable excuse for not registering for VAT

Summary - The First-tier Tribunal allowed the appeal in part against HMRC's decision to assess VAT in the absence of VAT returns and to penalise late registration.

The taxpayers' business traded as a café with standard and zero-rated sales. It did not register for VAT, despite trading above the threshold from 1 April 2009 to 31 March 2013.

In December 2014, HMRC registered the business with effect from 1 April 2009 and raised an assessment to collect the VAT plus a penalty.

The taxpayers appealed. They blamed their accountant for telling them that zero-rated sales were not included in the VAT threshold. They accepted that the outstanding VAT was due but said the penalty was unfair because they had not acted deliberately or tried to evade VAT.

Decision:

The First-tier Tribunal agreed that the taxpayers should be registered from 1 April 2009. They did not have reasonable excuse for not registering because 'ignorance of the law and reliance upon another for advice' was no basis for this. However, the judge noted that HMRC had made no allowance for zero-rated sales in the assessment calculations (deemed by the court to be 30% of total sales) or a lower VAT rate of 15% in 2009. As a result, the assessment and penalty were substantially reduced.

The taxpayers' appeal was allowed in part.

Comments - This case illustrates how an outstanding VAT liability can mount up significantly after a period if the law is misunderstood.

J Ready and L Jones trading as The Open Kitchen Café v HMRC TC5030

Missing trader fraud

Summary – The Court of Appeal held that the FTT's decision was meticulous in detail and moved logically from point to point. It discloses no error.

The taxpayers operated in the 'grey market', selling goods outside the normal authorised distribution channels. They agreed to buy razor blades from an independent wholesaler, B, and sold them to a Spanish wholesaler. The taxpayers paid the wholesaler for the goods after they had been paid by the client in Spain.

The taxpayers claimed substantial input tax on the transactions. But HMRC refused on the basis the transactions were fraudulent and the taxpayers should have known they were connected with fraud.

Decision:

The First-tier Tribunal dismissed the taxpayers' appeal but the Upper Tribunal overturned that decision. HMRC appealed.

The Court of Appeal noted that HMRC had warned the taxpayers about missing trader intra-community fraud in the past, but the Upper Tribunal had not taken this into account in its assessment of what a reasonable person should have known about any connection with fraud.

Further, the taxpayers had previously bought goods from authorised distributors only and knew that B was unauthorised. The transactions were therefore not within the ordinary course of the taxpayers' business.

HMRC's appeal was allowed.

Comments - The Court of Appeal noted that HMRC had warned the taxpayers about missing trader intra-community fraud in the past, but the Upper Tribunal had not taken this into account in its assessment of what a reasonable person should have known about any connection with fraud.

CRC v Davis & Dann Ltd and another EWCA

Was the hire out of a room a supply of land?

Summary - The First-tier Tribunal dismissed the appeal against HMRC's decision that standard-rating applied to the hire of premises for a wedding reception.

The issue was whether the hire out of a room in which civil wedding ceremonies were carried out was an exempt supply of land or part of a single taxable supply of a 'wedding package' including catering, which was standard-rated.

The parties had agreed that the *Levob* test (Case C-41/04) should be applied: whether elements of a supply 'are so closely linked that they form objectively a single indivisible economic supply which it would be artificial to split'.

Decision:

The FTT found that customers could separate the elements of the wedding package 'without entering the realms of artificiality'. The FTT pointed out in particular to the physical separation of the wedding ceremony from the rest of the wedding celebrations and to the separate charge for the ceremony room on the invoice issued to customers.

The FTT also found that the supply of the room went beyond the passive letting of land. Although the FTT accepted that no additional services were provided with the room (such as flowers and the taking of photographs), customers paid a substantial fee for the hire of the room because it was licensed for carrying out civil weddings.

Why it matters: The FTT noted that it was unlikely that customers would have paid the significant fee for the hire of a bare room. The fee could only be explained by the fact that the service of a legal wedding ceremony was provided thanks to the licensed nature of the room.

Comments - A single price may be paid for a package of items, which might be more than one supply for VAT purposes. VAT law deals with a single price paid for a single, identifiable supply. There are at least two ways of deciding the treatment: (1) split the supply into component parts and treat each part as a separate supply; or (2)identify the most significant element of the supply and treat all the other components as part of that supply.

The onus of proof was on the taxpayer to demonstrate that HMRC's decision was not correct to the normal civil standard of proof, i.e. on the balance of probabilities.

Blue Chip Hotels v HMRC TC 5078

Scope of the exemption in respect of payments and transfers

The decisions in these two cases were delivered on 26 May 2016

Summary - The ECJ held that the processing of payment by debit or credit card did not, in the circumstances of this case, amount to an exempt financial transaction, but merely applied technical and administrative means which enabled NEC to collect information to communicate with the bank. However, it remained for the referring court to ascertain whether NEC's card processing service was ancillary to the sale of the tickets concerned or to another service provided by the NEC to the purchasers of those tickets.

The NEC owned and operated the National Exhibition Centre and other venues in Birmingham, which were used to stage trade and public exhibitions, sporting events and concerts. It hired its venues to third party promoters and sold tickets for those events. The NEC refunded the event promoter the part of the amount paid by the customer corresponding to the ticket price and kept the amount corresponding to the booking fee. The issue was whether the service provided by the NEC fell within the art 13B(d((3) exemption, so that no VAT was due on the booking fee.

Decision:

The court noted that the card processing service provided by the NEC resulted in a payment or transfer within the exemption. However, it added that the mere fact that a service was essential for completing an exempt transaction did not warrant the conclusion that that service was exempt. As the NEC did not debit or credit the accounts concerned, it could not be regarded as executing the payment or transfer. The court concluded that the NEC merely collected information, communicated that information to the merchant acquirer bank and received information, which enabled it to make a sale and receive the corresponding funds.

Comments - The decision in this case and the contemporaneous decision of the ECJ in Bookit Ltd v R & C Commrs make it clear that credit and debit card handling services do not, in themselves, qualify for exemption from VAT. There appeared little doubt in the minds of the presiding judges that the exemption, which covers transactions concerning payments and transfers, does not extend to card processing services and that the services should, therefore, be standard-rated in the normal course of events. However, the court was at pains to emphasise the established principle that unless services supplied to persons buying tickets are distinct and independent supplies in their own right, they should, together with the principal service, form a single supply and attract the same VAT treatment as the predominant element of the supply. This might assist non-profit making bodies whose cultural or charitable events are exempt from VAT by enabling card processing fees to be treated as further consideration for an exempt supply.

HMRC v National Exhibition Centre (Case C-130/15)

Summary - The ECJ decided that Sixth VAT Directive art 135(1)(d)) *must be interpreted as meaning that the exemption from VAT provided for transaction concerning payments and transfers is not applicable to a 'card handling' service.*

Bookit, a subsidiary of Odeon Cinemas, charged card handling fees to customers making advance bookings for cinema tickets. Until 2001, Odeon had provided these services itself. After consulting Deloitte & Touche, it had then restructured its ticket sales in order to ensure that the card handling fees were exempt from VAT. The issue was whether the card handling services were actually exempt.

Decision:

Having stated the same principles as in the *NEC* case released on the same day (see above), the CJEU found that like the NEC, Bookit played no specific and essential part in effecting the transfers of funds, so that the services it provided did not fall within the exemption.

Bookit Ltd v Revenue and Customs Commissioners (Case C-607/14) [2016] BVC 21

Sale and leaseback and change of use

Summary - The First-tier Tribunal allowed the appeal against HMRC's decision that Balhousie Holdings Ltd ('BH') was liable to a self-supply charge, following its disposition of a care home.

BH operated care homes and formed a VAT group with its subsidiaries, including BC. One of BH's subsidiaries, FC, was not part of the VAT group. In view of the difficulty of obtaining loan finance, BC had entered into a sale and leaseback arrangement as a means of raising finance. Three properties had been sold to Target Healthcare REIT, which had immediately granted leases back to BC. One of the properties, which had been acquired by BC from FC, had been a newly completed care home. This purchase by BC had been treated as a VAT zero-rated first grant of a major interest in a relevant residential property. HMRC considered that the onward sale and leaseback were two separate transactions, so that the sale had triggered a liability to a self-supply charge to VAT as a result of the change of use.

Decision:

The tribunal considered, however, that given that the sale and leaseback had been implemented as an alternative to bank lending, the transactions should be looked at as a composite transaction, as one would not have happened without the other. In the context of para 36 Sch 10 VATA 1994, the transaction which caused the taxable event was the disposal of an entire interest and this was not achieved where there was a sale and leaseback. Furthermore, the legislation was clearly intended to ensure that use continued for relevant residential purposes. BH was still responsible for the use of the buildings under the leases; there had been no change of use.

Comments - The legislation aimed to ensure that use of the building continued for relevant residential purposes. The FTT did not consider that policing of such use was required, as BH was still responsible for using the building. Its use, before and after 8 March 2013, was the same. The requirement for VAT to be accounted for on the original supply as output tax applied only if the taxpayer disposed of his entire interest in the premises within ten years of the supply. If BH had been liable to a self-supply, the VAT due would have been the amount that would have been chargeable on the zero-rated supply, i.e. the purchase of the property by BC from FC. HMRC estimated that charge at £801,492

Balhousie Holdings v HMRC TC5131

Mobile devices for handicapped persons

Summary – The First-tier Tribunal allowed the appeal against HMRC's decision that zero-rating does not apply to supplies of mobile phones and tablets, with a software package pre-installed ('Capturatalk')

Group 12 Sch 8 VATA 1994 allows zero-rating for drugs, medicines and aids for the handicapped. Item 2(g) includes the supply of equipment and appliances designed solely for use by a handicapped person. Iansyst supplied IT software and hardware for persons with disabilities, including visual impairments and persons with dyslexia. For example, Capturatalk was a software which (when installed on a mobile phone or tablet computer) read text aloud. The issue was whether these supplies of mobile devices fell within the scope of Item 2(g) and were therefore zero-rated. This depended on whether they were designed solely for use by a handicapped person.

Decision:

The FTT observed that zero-rating was an exemption which should be interpreted strictly but that a 'strict' construction differed from a 'restrictive' construction. The question was therefore whether a fair interpretation of the words 'designed solely for use by handicapped persons' included the supply of mobile devices with software installed by Iansyst. The FTT added that the requirement for the design to be 'solely' for handicapped persons would be very difficult to meet, if it meant that the item in question was not in any way useful to a non-handicapped person. However, the FTT found that the package as a whole allowed a handicapped person to use the device differently from the way in which a non-handicapped person would use it; and to use it more effectively than without the technology installed. The supplies should therefore be zero-rated.

Comments - The requirement for the design to be 'solely for handicapped persons' would be difficult to meet if it meant that the item must in no way be useful to a non-handicapped person. The case was a forward-looking appeal, i.e. it did not relate to any actual supplies of mobile devices with Capturatalk installed. Although there were no actual supplies, the FTT heard the appeal, as HMRC's decision affected the amount of 'VAT chargeable on the supply of goods'. The FTT's findings relate only to the law as at the date of that decision, i.e. 9 September 2014.

Since the appeal did not relate to any specific supplies of mobile devices, the FTT did not consider the meaning of the pre-amble of item 2, i.e. the requirement that the supply must be made to 'a handicapped person for domestic or his personal use, or to a charity for making available to handicapped persons by sale or otherwise, for domestic or their personal use'. This condition must also be met for zero-rating to apply to a particular supply.

Iansyst v HMRC TC5126

HMRC revise flat rate scheme notice 733 (Lecture B965 – 14.03 minutes)

Background

The FRS is intended to simplify the VAT affairs of a small business, and a business is eligible to join if its expected taxable sales in the next 12 months are £150,000 or less (excluding VAT). The business owner chooses a flat rate category from a list of 51 different categories, and applies the relevant percentage for that category to his gross business income, apart from income that is outside the scope of VAT. A scheme user only claims input tax in relation to pre-registration input tax if it uses the scheme from when it first registered for VAT, or if it buys capital goods that cost more than £2,000 including VAT. This is because the flat rate percentages reflect the average loss of input tax for the business in question.

As many advisers will be aware, HMRC have lost a number of First-tier Tribunal (FTT) cases about flat rate scheme categories, where they took the view that their own guidance about what businesses belonged to each category had the force of law. This is wrong, and the cases were relevant to two main sectors:

1. **Consultants** – the previous version of Notice 733 said at para 4.4 that consultants should choose the category for 'management consultants' even if they did not 'fit the traditional idea of management consultant'. So HMRC's previous view was that eg health and safety consultants and employment consultants should pay tax at 14% based on the management consultant rate rather than the 12% rate for 'business services not listed elsewhere' ie because there is no specific category for these consultants. The revised Notice 733 issued on 4 May 2016 has removed this paragraph and added the comment that a business should 'use ordinary English' in choosing its flat rate category, and confirms that 'HMRC have offered an interpretation of each sector' in their guidance (para 4.1) – the previous notice (and view of many officers) indicated that HMRC's views about where businesses belonged had the force of law.

Example 1

John is a tax consultant who gives advice on capital gains tax to individuals and businesses selling property. When he joined the flat rate scheme, he followed the advice given by HMRC in VAT Notice 733 that he should pay 14% tax by adopting the management consultant category. However, the revised Notice 733 advises John to 'use ordinary English' to choose his rate. In other words, if he met someone at a party for the first time, how would he describe his business to that person ie he would not describe himself as a 'management consultant' but as a 'tax consultant'. And because there is no specific category for 'tax consultant', he should therefore choose the rate for 'business services not listed elsewhere' ie with a rate of 12%.

2. **Engineers** - the other exclusion in the revised notice (also from para 4.4) is that engineering consultants and designers should always choose the category for 'architect, civil and structural engineer or surveyor' at 14.5%. This was the key outcome in the FTT cases of SLL Subsea Engineering Ltd (TC4256) and Idess Ltd (TC3638) where the courts concluded that 'mechanical engineers' were not 'civil engineers' because the latter work on land related projects whereas a mechanical engineer works on plant and machinery. Mechanical engineers were therefore correct to choose the 'business services not listed elsewhere' category at 12% because there is no specific category for their business.

Example 2

Harry set up his business two years ago, mainly working for his former employer. His main activity is to design vehicle stopping systems for manufacturing businesses. He creates animations to illustrate the effectiveness of the designs and generally assists the design process. He describes his activity as a 'mechanical engineer' using ordinary English. There is no FRS category for mechanical engineers so he should choose the 12% rate for 'business services not listed elsewhere'.

Tips on choosing a category

The starting point for a business adopting the FRS for the first time, and choosing its category, is to use the list of categories in the 1995 VAT Regulations, SI1995/2518, Reg 55K, which can be found with a direct link from para 4.3 of the revised notice. In areas of doubt (eg where there is no specific category for the business description) HMRC offer assistance in their guidance notes FRS7200 and FRS7300 (a link is given in para 4.1) which now reflect recent court cases. The link refers to HMRC's 'interpretation of each sector'. Notice 733 confirms at para 4.2 that: "HMRC will not change your choice of sector retrospectively as long as your choice was reasonable. It will be sensible to keep a record of why you chose your sector in case you need to show HMRC that your choice was reasonable."

HMC Notice 733, para 7.7

This Notice lists some common errors made on VAT returns

- failure to include any VAT on EC acquisitions in box 2
- failure to account for VAT on EC acquisitions in box 2 at the standard rate
- 'None' (or '£0.00' for online returns) missed out of box 4
- forgetting to include exempt income, like rent, in the turnover to which the flat rate is applied
- VAT exclusive figurein box 6, meaning that flat rate is applied to net, rather than gross turnover
- the 1% reduction is applied by businesses that have been registered for more than 12 months

The most important point is probably the need to include both exempt and zero-rated income in the scheme calculations. So if a business person is VAT registered as a sole trader hairdresser, but also owns a buy-to-let property in his or her own name, then the rental income is captured by the scheme.

This is not a good outcome and withdrawing from the scheme might be a good move. The scheme also captures the sale of a business car, even though output tax is not charged on the sale proceeds in most cases.

Example

John is a builder and has always used the FRS (rate of 9.5%). He retired on 30 September 2016 and deregister on that date. On 31 March 2017, John received an invoice from his accountant for £500 + VAT for producing his final business accounts. Can he claim £100 VAT back from HMRC on this invoice?

As John left the FRS on 29 September 2016, he is entitled to the same input tax relief on post-deregistration expenses as a non-scheme user. John should complete form VAT427 to reclaim £100 input tax on his accountant's invoice.

Reference: HMRC Notice 733, para 12.4

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