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Personal Tax

Termination payments for footballers (Lecture P966 – 10.55 minutes)

In view of the insecure nature of footballers' jobs and the more than generous remuneration which most top players receive, it is surprising that tax cases involving termination payments for such sportsmen have not occurred with a greater degree of frequency.

The first case which comes to mind is the well-known House of Lords decision in *Shilton v Wilmshurst (1991)* where a payment of £75,000 in 1982/83 to a Nottingham Forest (N) player for agreeing to be transferred to Southampton (S) was held to be fully taxable as earnings under what is now S62 ITEPA 2003. It did not represent a termination payment (as the footballer had argued), in which case the first £30,000 would have been exempt from income tax. The payment by N was made to induce the player to become an employee of S, and for no other reason. It was therefore treated as an emolument of his employment with S and was taxable accordingly.

A not dissimilar issue arose in *Tottenham Hotspur Ltd v HMRC (2016)* which was heard this summer by the First-Tier Tribunal. Payments to two players in connection with the termination of their contracts came under the scrutiny of HMRC. It is perhaps a sign of the times that, on this occasion, the income tax concern – could the first £30,000 of each payment be held to be tax-free by reason of S403 ITEPA 2003? – was a good deal less important than the potential NIC liability.

The Tottenham Hotspur (T) footballers were Peter Crouch and Wilson Palacios. In August 2011, the club agreed terms with these two players (who were still under contract with T) which involved them leaving T and joining Stoke City. The case concerned the tax and NIC treatment of the payments which T made to the players.

HMRC considered that the payments were earnings from the footballers' employments and, as such, fully subject to income tax and NICs. T argued that the payments represented compensation for the early termination of the players' contracts and was not, therefore, 'from' their employments, in which case S403 ITEPA 2003 would be in point for income tax purposes and any NIC charge would fall away.

Although the key wording of the income tax and NIC charging provisions is slightly different, viz:

(i) for income tax, the question was whether the payment constituted 'an emolument of the employment'; but

(ii) for NICs, the question was whether the payment represented 'any remuneration or profit derived from an employment',

it was agreed that, in the context of this dispute, the tests set out in both sets of legislation were effectively identical so that any income tax case law was equally relevant to the question of whether the payments were 'from' the players' employments for NIC purposes.

The outcome of the case depended, in large part, on an analysis of the players' contracts. Where a payment such as a termination payment or a payment in lieu of notice arises under the terms of the contract, it is always taxable in full given that it is part of the reward arising from the contract itself. HMRC's contention was that, because each player's contract contained an express provision that it could be terminated by mutual consent, a payment which resulted from any such termination was therefore taxable. Each of the taxpayers, on the other hand, claimed that it was a payment by way of compensation arising from a breach of the contract.

One eminent tax expert summarised the First-Tier Tribunal's position with these words:

'The Tribunal did not agree with either of the parties. They did not consider that the club was in breach of contract, even though the club threatened to leave (one of) the players out of the squad and off the bench for two years. This did not involve a breach (or anticipatory breach) as there was no implied term that he should be considered for selection. Neither did the Tribunal consider that the provision for termination by mutual consent was relevant either. They made the keen observation that a contract can always be terminated or varied by mutual consent. Therefore, a clause permitting the parties to terminate the contract by mutual consent adds nothing to the rights of the parties.'

In the end, following the decision of the Court of Appeal in *Henley v Murray (1950)*, the Tribunal decided that the parties had reached an agreement for the contract to be terminated and a sum was paid in consideration. A payment made as part of a mutual agreement to terminate an employment is not a payment 'from' the employment. Accordingly, the sums paid fell outside the charging provisions for NICs and, for income tax purposes, they qualified for the £30,000 exemption.

Given that the amounts involved were substantial, it seems probable that HMRC may seek to take this case further.

Contributed by Robert Jamieson

Unfortunate consequences with application to withdraw EIS compliance form

Summary - The First-tier Tribunal found that an EIS investment was made at the time the shares were issued if a compliance statement was (at any time) provided.

The taxpayer was incorporated in June 2013. In August it issued 42,856 £1 shares to two investors and completed forms for the enterprise investment scheme (EIS) and seed enterprise investment scheme (SEIS).

In September 2014, the taxpayer's accountant filed form EIS1 asking for HMRC's agreement that the shares qualified for EIS relief. The department authorised the relief in December 2014. The accountant then asked to withdraw the EIS application on the ground that the form had been completed in error; instead the SEIS compliance form should have been submitted.

HMRC refused and the taxpayer appealed.

Decision:

Referring to the similar case, *X-Wind Power* (TC5086), the First-tier Tribunal said the combination of the taxpayer issuing shares and submitting the EIS1 on the same day meant that EIS investment took place on 15 August. The requirement for SEIS in ITA 2007, s 257DK that no EIS investment had been made by the issuing company on or before the day on which the shares were issued was not met.

The judge expressed sympathy that a 'small mistake' had led to 'significant financial consequences', but the law was clear. As stated by the tribunal in *X-Wind Power*, the legislation did 'not ask why a compliance statement under ITA 2007, s 205 has been made, it simply asks whether it has been made'.

The taxpayer's appeal was dismissed.

Comments - The company had attempted to distinguish the recent case of X-Wind Power Ltd TC5086 on the grounds that the mistake was discovered less than six weeks after authorisation of the EIS compliance statement. Unfortunately the FTT found that it was the fact that the statement had been made not the question of why it was made that was relevant for the purposes of s257DK.

GDR Food Technology Ltd v HMRC TC5219

De minimis share rights cannot be ignored with EIS relief

Summary - The Upper Tribunal found that the statutory wording of the EIS provisions had to be strictly applied in determining whether or not ordinary shares carried a preferential right.

Flix Innovations Ltd ('the Company') required further finance in order to meet the costs of developing and marketing the Company's product. In order to make an investment in the company more commercially attractive to other investors, the company's share capital was reorganised to convert some of the share capital held by the two founder shareholders into deferred shares that ranked after the ordinary shares in terms of repayment of share capital on a winding-up (and had no rights to share in any surplus).

As the holders of the ordinary shares were entitled to repayment of the nominal value of those shares before the holders of the deferred shares, HMRC considered that the ordinary shares did not meet the requirement in s173(2)(aa) ITA 2007 that they should not, at any time in period B, carry any present or future preferential right to the company's assets on a winding-up. HMRC therefore refused to authorise the issue of EIS compliance certificates.

The company appealed, on the basis that, on a purposive construction, the term 'preferential right' should be given an ordinary commercial meaning rather than a technical meaning so that an insignificant preferential right would be ignored, and that the *de minimis non curat lex* principle of statutory interpretation would also ignore the trivial preferential rights.

The FTT took the view first that Parliament's failure specifically to provide for small preferential rights in the 'closely articulated' EIS regime evidenced a contrary intention and second that since the obligation to certify compliance with all necessary conditions was placed on the company that issued the EIS shares, it was more likely that the intention was to provide a clearly-worded test that did not rely on principles of statutory construction that were only likely to be understood by lawyers.

Decision:

The Upper Tribunal, held that the de minimis principle did not apply. Parliament had legislated that any preferential right debarred relief: 'It was not possible to use purposive construction to give effect to a perceived wider policy in cases where the words used will not bear that meaning.'

Comments - Although not relevant to the decision, it is interesting to note that the Upper Trbunal did not accept that the preferential rights were *de minimis* because (unlike the FTT) they considered that the value of the right (entitlement to repayment of nominal value of £933) should be compared to the total nominal value of the company's shares (£1,083) rather than the total market value (c. £2.2m). This case may be relevant beyond EIS - the de minimis rule cannot apply where Parliament has given a clear indication to the contrary, for instance by using the term 'any'

Flix Innovations Ltd v CRC, Upper Tribunal

Payrolling of benefits – is it worth it? (Lecture B967 – 8.58 minutes)

From 6 April 2016 employers may register on a voluntary basis to report and account for tax on certain benefits and expenses via the RTI system rather than by submitting Form P11D at the tax year end.

Registering to payroll

To be able to payroll benefits the employer must have registered to do so by the start of the tax year:

- 2016/17 – no later than 5 April 2016
- 2017/18 – no later than 5 April 2017

They should go the HMRC website and search 'Payrolling Benefits'. By following the HMRC link the employer will be able to register for payrolling of benefits for the following tax year.

When registering the employer selects only those benefits that they wish to include in the system. In 2016/17 payrolling can apply to cars, fuel, healthcare, gym subscriptions but not to beneficial loans, living accommodation or vouchers. However, from 2017/18 vouchers can also be payrolled.

Once HMRC have confirmed the registration, the registration will role forward each year. When an employer wishes to come out of the system then they can do so by notifying HMRC and they will then come out of the system at the start of the next year.

How the system works

Some software providers were able to process the benefits through payroll for 2016/17 with most being able to do so from 2017/18.

Having logged into their payroll software, the employer simply ticks ‘payrolled’ against the benefit in kind. The employer then inputs the annual benefits being payrolled and the software will divide the benefits by 12, if paid monthly, and include this amount as income when calculating the income tax due for the month.

The employer must inform its employees that they are payrolling benefits and they can use the standard HMRC templates that are available on the HMRC website to do so. The payrolled benefits should appear as a separate item on the employees’ payslip. At the end of each tax year, the software will produce a benefits summary for each employee. All payrolled benefits are reported in the employer’s Full Payment Submission

Note that this has no impact for national insurance which is accounted for separately. So at the year end the employer will still need to complete Class 1A Form P11d(b) by 6 July following the end of the tax year. Form P46(Car) does not need to be completed as this is being done by the RTI system.

Advantages

This system has a number of advantages:

- No need to complete the P11d for the selected benefits
- The risk of P11d penalties for incorrect or late submission is removed
- Employees are more likely to pay the right amount of tax as benefits will be in real time
- Payrolling software should make payrolling benefits simple to process

Disadvantages

It also has disadvantages.

- The requirement to complete a P11d(b) remains for Class 1A
- If the employer operates the payroll incorrectly there will be penalties so benefits must be carefully monitored and updated regularly
- If the employee receives non-payrolled benefits then a P11d is still required for those benefits
- Employers cannot remove employees from payrolling part way through a year unless the 50% withholding rule is breached or the employer stops paying the employee
- An annual benefit summary must be given to the employee by 1 June following the tax year end which is earlier than the P11d deadline

Capital Taxes

Government amendments to investors' relief (Lecture P969 – 21.06 minutes)

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

Shares disposed of qualify for investors' relief provided that they satisfy each of the conditions set out in S169VB(2) TCGA 1992 (as inserted by Para 2 Sch 14 FB 2016):

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

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

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

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

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

(vi) neither the investor nor any person connected with him should have been an employee of the company (or any connected company such as a subsidiary) during the period in which he held his shares.

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

In advance of the Committee of the Whole House Proceedings on 28 June 2016, the Government announced no fewer than 30 amendments to their original legislative proposals on this important relief. The main changes are summarised below:

(i) Joint holders (eg. husband and wife) can qualify for investors' relief. Initially, it was only available for sole shareholders. This seemed surprising in view of the fact that entrepreneurs' relief has always been claimable by joint shareholders (provided, of course, that each meets the 5% test on a pro rata basis).

(ii) Trustees were also excluded by virtue of the fact that, to begin with, S169VC(6) TCGA 1992 described a qualifying investor as an 'individual'. This has been replaced by new S169VC(7) TCGA 1992 which reads:

'In this Chapter a "qualifying person" means:

– an individual; or

– the trustees of a settlement.'

The revised legislation then proceeds to detail the circumstances when shares held by trustees can attract the relief. New S169VGA TCGA 1992 provides that, if there is a disposal of shares by the trustees of a settlement, investors' relief will be available where there is at least one individual (referred to as an 'eligible beneficiary') who has had an interest in possession in the qualifying shares throughout the previous three years and has at no time in that period been an employee of the company which issued the shares. The trust beneficiary must notify the trustees that he wishes to be treated as an eligible beneficiary. Where there are two or more persons who have an interest in the shares disposed of, each of whom individually would satisfy the requirements of S169VGA TCGA 1992, the relevant gain has to be divided between them in accordance with their respective beneficial interests. A claim for investors' relief, in the case of a trust disposal, must be made jointly by the trustees and the eligible beneficiary (or beneficiaries). This claim must be made by the usual time limit of the first anniversary of 31 January following the tax year in which the disposal was made.

(iii) The rules for the £10,000,000 cap have been amended where there are qualifying trust gains. Any investors' relief comes out of the eligible beneficiary's £10,000,000 limit. Where there is more than one beneficiary so that the relief is apportioned, an appropriate amount of relief is deducted from each eligible beneficiary's lifetime limit. This means that, where one beneficiary has exhausted his own limit, no relief is available in respect of that portion of the gain.

(iv) Two significant new sections are Ss169VQA and 169VQB TCGA 1992. These provisions ensure that certain officers (and employees) of the company can in fact benefit from investors' relief. They are primarily, but not exclusively, aimed at business angels, ie. entrepreneurial individuals who, in return for an investment in a company, become closely involved in its growth and development. As a general principle, someone who is an officer or employee of the issuing company or a connected company is unable to qualify for investors' relief. However, the first of these new sections provides that this exclusion does *not* apply if that person is a 'relevant employee'. A relevant employee is a person who:

– becomes an 'unremunerated director' of the company or a connected company following his share purchase; or

– becomes an employee more than 180 days after the share issue (and there was no reasonable prospect of this outcome at the time of the share issue).

The second new section defines the term 'unremunerated director'. The main requirement is that the investor must never have been involved with the issuing company before making his investment and he must not have received any 'disqualifying payments'. This means any payment other than:

– the reimbursement of travelling or other business expenses;

– interest which represents a reasonable commercial return on money which he has lent to the issuing company;

– a dividend which does not exceed a normal return on his investment;

– the payment of rent for any property occupied by the issuing company which does not exceed a reasonable commercial rent for the use of the property; and

– a payment for the provision of services to the issuing company which relate to a trade or profession carried on wholly or partly in the UK (eg. for accountancy or legal work).

These all appear to be very sensible improvements to the overall scheme of investors' relief.

Contributed by Robert Jamieson

Mixed partnerships and incorporation relief **(Lecture B966 – 12.32 minutes)**

In a letter to the CIOT dated 4 February 2016, HMRC announced an important change of practice in relation to their position on S162 TCGA 1992 incorporation relief and mixed partnerships (ie. partnerships which include both individuals and a company).

Nowadays most mixed partnerships are LLPs. The income profits of the business are shared between the individual and the corporate members, while the capital profits are predominantly attributable to the individuals.

Following the introduction of the revised regime for partnership taxation in FA 2014, a number of LLPs decided to turn themselves into limited companies. In order to effect this:

(i) the individual members would exchange their partnership interests in return for the issue of additional shares in the company partner; and

(ii) the corporate member would effectively maintain its position, given that it could not issue shares to itself (although it would take over the business and assets of the LLP).

In this scenario, the individual members hope to avail themselves of the rollover relief in S162 TCGA 1992.

However, in order for the relief to apply, S162 TCGA 1992 stipulates that the whole of the partnership business should be transferred. In this context, Para CG65700 of the Capital Gains Manual states:

'Relief is available to individuals who are partners (even if one or more of the other partners is a company) where the whole of the partnership business is transferred to a company as a going concern.'

This sounds definitive, but concern was expressed that, in this situation, the corporate member's interest in the partnership has not been 'transferred'. The counter-argument was that the business carried on by the LLP is distinct from the member's interest in that business and that this has indeed been transferred to the company.

In view of this dilemma, the CIOT contacted HMRC in 2014 for a ruling on the matter and, in a reply from 'Capital Gains – Technical' in Solihull, one of HMRC's Technical Advisers wrote the following:

'We would, subject to all the other conditions being satisfied, accept that S162 TCGA 1992 can apply to the individual members where an LLP transfers its business to the corporate member in exchange for shares in the corporate member. S59A(1)(b) TCGA 1992 treats any dealings by the LLP as those of its members (and) so the transfer of its business by an LLP will be treated as a transfer by its members. Relief would be available to the extent stated in S162 TCGA 1992 to any individual member who received shares in exchange for the business.'

So far so good. As a result, a considerable number of mixed LLPs duly incorporated their businesses.

Then, nearly two years later, the letter referred to above was received by the CIOT. In this communication, a different Technical Adviser explained that HMRC had reconsidered their previous position in view of the fact that, because members of an LLP are regarded as each having a fractional share of all of the partnership assets, 'the whole of the assets of the business' cannot logically be transferred to the company, given that some of these assets are already deemed to be held by the corporate partner. In other words, relief under S162 TCGA 1992 was no longer available.

This revised interpretation could have proved problematic for many of the LLPs which had recently incorporated, except that, sensibly enough, the Technical Adviser's latest letter included the following paragraph:

'To ensure a fair treatment I am proposing to introduce this change with an effective date of 30 April 2016. HMRC did not publish any new guidance in relation to this issue (and) so I would suggest that the CIOT may wish to advise their members of the change in position. We will update our published guidance as soon as possible to cover this issue in more detail.'

Thus incorporations of LLPs which took place before 30 April 2016 will be dealt with in accordance with HMRC's original practice as set out in their 2014 letter.

Understandably, the CIOT made it clear that they still had concerns about HMRC's approach being counter-productive when viewed in the context of:

(i) the policy objective of S162 TCGA 1992; and

(ii) encouraging the dismantling of mixed partnerships (which HMRC are keen to speed up).

Therefore, they asked HMRC to consider introducing a specific statutory relief so that the provisions of S162 TCGA 1992 would continue to be in point when mixed partnerships incorporate in the manner described above. This request is now being looked at.

Contributed by Robert Jamieson

Entrepreneurs' relief and own share purchases (Lecture P968 – 9.16 minutes)

The recent First-Tier Tribunal decision in *Moore v HMRC (2016)* illustrates how overlooking small details can prove to have very costly consequences when making a claim for entrepreneurs' relief.

Mr Moore (M) was a founding shareholder director of Alpha Micro Components Ltd (Alpha) which was established in 1995. He owned 30% of the company (3,000 out of 10,000 shares) and was employed as the Sales and Marketing Director. During the course of 2008, there was a dispute between the shareholder directors over the future direction of Alpha's business, which ended in M agreeing to leave the company. The parties entered into a Compromise Agreement under which M's employment was terminated and Alpha contracted to buy back his shares. Papers were filed at Companies House stating that M had resigned his position on 28 February 2009. However, the company did not resolve to repurchase M's shares until 29 May 2009.

The entrepreneurs' relief legislation in S169I(6)(b) TCGA 1992 stipulates that the disponor must have been an officer or employee of the company throughout a period of one year ending with the disposal of his shareholding. HMRC contended that M had failed this condition by virtue of his earlier resignation from the company. He was not therefore entitled to make a claim for entrepreneurs' relief.

M, on the other hand, argued that the disposal of his shares was effective from the date of the Compromise Agreement on the basis that there was an unconditional obligation on the part of the company to buy back his shares. However, this argument was not accepted by the Tribunal. S694 Companies Act 2006 requires there to be the passing of a special resolution before a purchase of own shares can take place. This did not occur until 29 May 2009 and so the company, as a matter of law, was incapable of entering into a valid contract any earlier than the May date.

This case serves to demonstrate the importance of clients seeking professional advice before undertaking transactions of this nature. M's loss of entrepreneurs' relief could easily have been avoided if the whole process had been properly thought through. In particular, it was noted that M, despite resigning his directorship, had continued to do work for Alpha, but via his own personal service company (JM Technology Solutions Ltd) and not as an employee. If M had been put on a reduced-status employment (or even given gardening leave), he would have satisfied the relevant conditions.

Alternatively, if Alpha had passed the special resolution at the time when the heads of terms for his departure were drawn up, this would have dealt with the Companies Act 2006 provisions and entrepreneurs' relief would have been available.

Contributed by Robert Jamieson

Shares with no right to a dividend (Lecture P967 – 16.17 minutes)

In *McQuillan v HMRC (2016)*, the First-Tier Tribunal held that a class of redeemable ordinary shares with no dividend entitlement constituted shares which have a right to a dividend at a fixed rate and therefore did not form part of the ordinary share capital of the company concerned.

The taxpayer (M) and his wife formed a company in 2004. Initially, its issued share capital consisted of 100 £1 ordinary shares, of which 33 were held by each of M and his wife. The remaining 34 shares were owned equally by M's sister (P) and her husband. Mrs P and her husband subsequently lent £30,000 to the company.

The company's business was successful and grew rapidly. In 2006, they approached Invest Northern Ireland (INI), which is a regional business development agency, for a grant. INI agreed to provide the grant on condition that the loan from Mrs P and her husband was converted into shares. At a board meeting on 12 June 2006, it was duly resolved that the £30,000 advance be converted into 30,000 redeemable ordinary shares of £1 each. These new shares carried no votes and were redeemable at par on a future date to be decided by the directors.

Towards the end of 2009, a much larger business offered to buy up the company. Accordingly, at a board meeting on 14 December 2009, the directors resolved that the 30,000 redeemable ordinary shares be repaid at par with immediate effect. Nine days later at a further meeting, it was resolved to pay a dividend for the period ended 31 October 2009 of £700 per share. This was the only dividend which the company ever paid. On 1 January 2010, the purchasers acquired all of the 100 £1 ordinary shares and the four shareholders then ceased to have any involvement with the company.

M and his wife claimed entrepreneurs' relief in respect of their capital gains in the CGT pages of their 2009/10 tax returns which, following an enquiry, HMRC refused to allow. The HMRC stance was that the 30,000 redeemable ordinary shares counted as 'ordinary share capital' and so, although Mr and Mrs M had been directors of the company throughout, they did not satisfy the requisite 5% shareholding test for the one-year period ended with the date of their disposal – M, for example, held 33 shares out of a total issued share capital of 33,100, ie. just under 0.1% of the company's ordinary share capital (using HMRC's definition).

On the other hand, the main argument put forward by M and his wife was that there was a significant difference between the redeemable shares and the other ordinary shares. The former had a fixed dividend of 0% and no voting rights. The latter entitled each of Mr and Mrs M to 33% of any dividend paid and 33% of the votes. A fixed dividend of 0% is a dividend at a fixed rate in the same way as a zero rate of VAT is a specific VAT rate.

The case report goes on to summarise the taxpayers' position as follows:

'To deny entrepreneurs' relief would be inconsistent with the spirit and intention of the legislation. Entrepreneurs' relief was introduced into the legislation only in 2008. At the time that INI required the £30,000 loan to be converted into redeemable shares in 2006, neither INI nor (Mr and Mrs M) could have realised that this might have implications for entrepreneurs' relief when it was subsequently introduced.'

It should be borne in mind that S989 ITA 2007 defines 'ordinary share capital' for this purpose as:

'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'.

In the end, the Tribunal answered this awkward question by saying that a right to no dividend is a right to a dividend at a fixed rate. Accordingly, the redeemable ordinary shares were excluded from the definition of 'ordinary share capital' and Mr and Mrs M were after all entitled to make their entrepreneurs' relief claim.

However, one tax expert warned:

'Whilst this represents a triumph for common sense given the configuration of the share capital in this case, there may be a number of people who have difficulty accepting the underlying analysis.'

Indeed, this decision goes against the long-standing HMRC view and appears to be at odds with the recent *Castledine* case where it was held that certain deferred shares (which had no value) had to be included in 'ordinary share capital' for the purposes of entrepreneurs' relief. It seems likely that HMRC will file an appeal.

Contributed by Robert Jamieson

More on the new dividend regime and discretionary trusts (Lecture P970 – 9.39 minutes)

Unfortunately, FB 2016 offers very little guidance on the impact of the new dividend regime, which took effect on 6 April 2016, and discretionary (or accumulation) trusts.

By virtue of S13A ITA 2007 (as inserted by Cl 5(5) FB 2016), discretionary trusts are unable to utilise the £5,000 dividend tax allowance and so such trusts suffer income tax at 38.1% on all their dividend receipts. Of course, to the extent that the standard rate band of £1,000 applies to dividend income, discretionary trustees only need to pay income tax at 7.5% on that slice.

The important question to determine, for 2016/17 onwards, is how much of this income tax goes into a discretionary trust's tax pool in line with Ss497 and 498 ITA 2007. Under the pre-6 April 2016 rules, any non-repayable tax credit attaching to dividends could not be added to the tax pool because of concerns that this could lead to it becoming repayable in the hands of an appropriate beneficiary.

However, there is now no non-repayable dividend tax credit and (ignoring the standard rate band) discretionary trustees have to pay income tax at the dividend trust rate on the whole of any dividends received – see above.

Rather oddly, FB 2016 contained no express announcement about a change to the tax pool provisions. As a result, the amount of tax which entered the tax pool was restricted to 38.1% – 7.5% = 30.6% where the dividend income fell into the bracket above the standard rate band limit of £1,000. Where the dividend income fell within the £1,000 band, no part of the 7.5% payment was allowed to go into the tax pool. This was clearly anomalous.

It has recently been confirmed that this was a drafting oversight. The Government plan to table an amendment to FB 2016 which will ensure that all of the income tax paid on dividend receipts by discretionary trustees will go into the tax pool. This is very welcome news.

Contributed by Robert Jamieson

Was a forfeited deposit an allowable loss?

Summary - The UT determined that the loss of a deposit on the forfeited purchase of a property could not be set-off against the gain realised on the sale of another property.

Mr and Mrs Hardy had entered into a contract for the purchase of a leasehold property. They had hoped to raise part of the purchase price by selling two properties but they had been unable to do so by the completion date. The vendor had rescinded the contract and kept the deposit.

Later in the same tax year, Mr and Mrs Hardy realised gains on the sale of the two properties and sought to set off the loss of the deposit against those gains. Mr Hardy's appeal against HMRC's rejection of the set-off had been dismissed by the FTT. His new ground was that when he had entered into the contract, he had acquired valuable contractual rights, which constituted an asset; and that when the vendor had rescinded the contract, those contractual rights had been extinguished, resulting in a loss in the amount of the forfeited deposit.

Decision:

The UT found that when a seller and a buyer enter into a contract for the sale of land, the seller does not dispose of an asset and the buyer does not acquire an asset. The asset, the land, is disposed of by the seller and acquired by the buyer when completion takes place. In any event, the buyer's loss of the right to enforce performance of the contract of sale, resulting in forfeiture of the deposit, did not amount to a disposal as it was akin to the abandonment of an option to purchase (s144 TCGA 1992).

Comments - Just because a taxpayer has suffered a loss does not mean that it is an allowable loss under CGT. It remains necessary to consider whether the legislative conditions are satisfied. In this case, they were not satisfied.

A Hardy v HMRC UKUT

Late filing of stamp duty land tax return

Summary – The penalty for the late filing of an SDLT return was upheld

The taxpayer appealed against a flat rate penalty of £200 for the late submission of a stamp duty land tax return. He said the freeholder's solicitor had said they would file the return but later it emerged that they expected the taxpayer to do it. The taxpayer then filed the return straightaway.

Decision:

The First-tier Tribunal had sympathy for the taxpayer but said 'the primary responsibility for the submission of the form' was with him. He could not rely on the inaction of the other party's solicitor to provide a reasonable excuse.

It was unfortunate that the solicitor was unable to deal with the form but no explanation for the delay was presented. Further, it seemed that the taxpayer had not chased the solicitor about the progress of the form to ensure it was submitted on time.

The taxpayer's appeal was dismissed.

Comments – As will be seen from the facts this was a reasonably open and shut case whilst the facts indicated that the decision was unfortunate it was really the only decision that could have been made.

A Oliver v HMRC TC5180

Administration

Validity of partner payment notices

Summary – A claim for judicial review of partner payment notices was dismissed by the High Court

HMRC issued the claimant members of partnerships set up by a company (FCP) partner payment notices (PPNs) under Sch 32 FA2014. The claimants sought judicial review of that decision.

They said Sch 32 did not give HMRC the power to issue PPNs to members of limited liability partnerships (LLPs). Further, no enquiry had been underway into two of the general partnerships and four LLPs because HMRC had not issued valid notices of enquiry into the relevant returns. Yet an enquiry was a precondition for the issue of PPNs.

Decision:

Mr Justice Cranston in the High Court said, 'in ordinary parlance', the terms 'partnership' and 'partners' covered general and limited liability partnerships and their members. There was no reason why that should not be the case with Sch 32. Although limited liability partnerships took a corporate form, the default terms for their internal affairs derived from the 1890 Partnership Act and the judge concluded they were 'probably best regarded as having a hybrid legal character'.

The judge said there was no prescribed form for a notice of enquiry and, as long as a taxpayer knew of the HMRC's decision to conduct an enquiry, that was sufficient. He said: 'The reality from early on with this tax avoidance scheme was that FCP knew that HMRC would be enquiring into the tax returns of the partnerships associated with it.'

There could be no doubt that FCP had been aware of the notices of enquiry into the relevant partnership returns and it had written to HMRC acknowledging them. Notice to FCP was, in effect, notice to the partnerships, in particular to their managing partner in the case of the general partnerships and their designated members in the case of the LLPs. The fact that they had known about the enquiry was sufficient for the purposes of the legislation.

The application was dismissed.

Comments - The High Court had previously granted permission for these judicial review proceedings to be brought on the basis that two of the issues raised were at least arguable (R (on the application of Sword Services Ltd) v R & C Commrs in 2015). However, in this judicial review hearing the High Court found that both challenges failed. The High Court ruled that: (1) as a matter of statutory construction PPNs applied to LLPs as well as general partnerships; and (2) although the partners making and delivering the returns did not receive formal notice of the enquiries, since they knew of the enquiries that was sufficient for enquiries to be in progress.

Sword Services Ltd and others v CRC, Queen's Bench Division

Effect of divorce - Late submission of returns and payment of tax

Summary – *The First-tier Tribunal allowed a taxpayer's appeal against penalties in respect of the late submission of two partnership tax returns and a personal tax return and partly allowed an appeal against penalties in respect of late payment of tax.*

The taxpayer filed her personal and partnership returns late. HMRC imposed penalties for late returns and late paid tax. She appealed, arguing that her husband, from whom she was separated, had denied her access to the businesses' accounting records and bank accounts.

Decision:

The First-tier Tribunal agreed that she had a reasonable excuse for the partnership return. She was neither the nominated nor representative partner and had been excluded from the management and direction of the partnerships. It was reasonable for her to assume that the partnerships' accountants would deal with the partners' returns properly.

On her personal return, the tribunal noted that she had previously relied on the partnerships' accountants to file it on her behalf, and accepted that she had not realised it had not been done until she was notified by HMRC. The tribunal described as 'strained' HMRC's proposal that she should have submitted a return herself with estimated figures. She was unable to obtain copies of past returns and had no access to the business papers. She therefore had a reasonable excuse for the late submission of the return.

Finally, on late payment of tax, the tribunal said the taxpayer's belief that the accountant would deal with it — as had happened in the past — constituted a reasonable excuse for part of the period. However, she could have made arrangements to make payments on account thereafter. The tribunal concluded the penalty should be reduced, although it should take into account that her ability to deal with the full value of her capital assets was hampered during the divorce.

The taxpayer's appeal was allowed in part.

Comments - The FTT found that the taxpayer's husband's actions during an acrimonious divorce, of excluding the taxpayer from their joint businesses, had provided her with a reasonable excuse for the late submissions and for some of the late payment. This case may be useful for other taxpayers in other circumstances where a relationship breakdown leaves one party excluded from a business with the result of them being unable to complete their tax return or access funds to pay a tax liability.

E Porter v HMRC TC5156

Withdrawing from the cost shifting regime

Summary - The FTT refused an application to withdraw a request to opt out from the costs shifting regime. The FTT also refused an application to adduce a 'without prejudice' letter as evidence.

This case was a case management hearing. The case had been categorised as complex but the appellants had opted out of the cost shifting regime. The appellants had then applied to withdraw their request to be excluded from potential liability to costs and HMRC had opposed the appellants' application.

Decision:

The FTT stated that the ability to opt out of the costs shifting regime under the FTT Rules 2009 rule 10(1)(c)(ii) was a one-off event available for a limited time only. This achieved certainty for both parties and prevented a taxpayer from obtaining an unfair advantage in relation to costs, by waiting to see how the case progressed before deciding whether or not to opt out. The question was whether the FTT had power to permit the appellant to withdraw a request to opt out of the costs shifting regime; and, if so, whether it should do so.

The tribunal found that it did not have such power. It noted inter alia that rule 17 allowed a party to revoke a notice of withdrawal, whilst rule 10 contained no such right. The FTT added that even if it had power to do so, it saw no reason 'to allow the appellants to change their minds'.

The other issue was whether a letter of 22 November 2011 from Deloitte to HMRC was without prejudice and, therefore, inadmissible. This depended on whether the letter was part of a negotiation with a view to settlement or merely an assertion of a party's rights. The use of the phrase 'without prejudice' at the top of the letter had no bearing on the issue. The FTT found that the letter was a 'without prejudice' communication. The tribunal noted in particular that the letter had been in response to HMRC's letter offering to 'discuss a framework to avoid litigation'; and concluded that the letter had been an 'opening shot' in negotiation. It had been accepted as such by HMRC, which had marked its reply 'without prejudice'.

Comments - The FTT noted that HMRC could potentially suffer financial prejudice if the Tribunal granted the application and the appellants were subsequently successful in the appeals and obtained an order that HMRC pay their costs. However, this did not give the Tribunal too much concern because HMRC had assumed that the appellant had not opted out of the costs shifting regime. Additionally HMRC accepted that it would have conducted the proceedings in the same way whichever costs regime applied.

N Brown Group plc & Anor TC 5198

Justification for a security notice?

Summary – The FTT partly allowed a taxpayer company's appeal against an HMRC notice requiring security for PAYE and NIC. The FTT found that while HMRC's decision (that the giving of security was necessary for the protection of the revenue) was not unreasonable, the amount of security required was excessive. This was because HMRC's calculation did not take account of ability to pay and none payment would have made the taxpayer criminally liable which would do nothing to protect revenue.

HMRC had issued a notice of security to D-Media in relation to PAYE and national insurance contributions (NICs) totalling £147,135 for a period of 24 months and D-Media appealed against the notice.

Decision:

The FTT observed that whilst the need for protection of the revenue was common to VAT security cases and PAYE cases, there was a significant difference in the way the legislation has been drafted in each case. The VAT security provisions only conferred a supervisory jurisdiction on the tribunal, whilst the Income Tax (PAYE) Regulations, gave it an appellate jurisdiction. The tribunal could therefore set aside or vary the notice.

The FTT also thought that HMRC's decision to issue the notice had been reasonable. There had been a continuing failure to remedy past arrears, and a failure to prevent a continuing accrual of PAYE and NICs debts. Security had therefore been necessary for the protection of the revenue. The FTT noted, however, that D-Media had not been able to provide security in the amount required by HMRC. The security should therefore have been limited to the tax due in relation to the previous four months: £25,000.

Comments - It is useful to note the differences pointed out by the judge between the provisions for a security for VAT and those for PAYE/NIC. For example for VAT it is a criminal offence to make taxable supplies if a security has not been paid in full, but for PAYE/NIC it is a criminal offence not to give the security in full. So for VAT it is necessary to do something other than merely fail to provide the security for there to be criminal offence so a trader could avoid committing a criminal offence by not continuing to carry on business. However for the recipient of a Notice which requires security for PAYE and/or NICs it could be criminally liable merely for failure to provide the security.

D-Media Communications v HMRC TC5183

Unreasonable decision of HMRC's refusal to suspend a penalty

Summary - The FTT allowed a taxpayer's appeal against HMRC's decision not to suspend a careless inaccuracy penalty. The FTT found that HMRC's decision was flawed because they had 'fundamentally misinterpreted' the legislation on suspension by arguing that as the taxpayer had been careless it meant that it was impossible to establish suspension conditions.

The taxpayer reported bank interest for 2014-15 in his 2013-14 tax return because the bank had given him the wrong year's certificate. Neither he nor his accountant noticed the error.

After an enquiry, HMRC found he had underpaid tax as a result. The same mistake had happened in the previous year, but this resulted in an overpayment.

HMRC issued a penalty saying the error was due to carelessness. It refused to suspend the penalty on the ground that the error had arisen because the taxpayer had been careless so there were 'no specific, time bound, measurable conditions' that could be set (under para 14 Sch 24 FA 2007).

The taxpayer appealed.

Decision:

The First-tier Tribunal said HMRC's decision not to suspend the penalty was flawed and '*Wednesbury* unreasonable' (*Associated Provincial Picture Houses Ltd v Wednesbury Corporation* in 1948 was a decision 'so unreasonable that no reasonable person acting reasonably could have made it'). It had 'fundamentally misinterpreted' Sch 24 para 14. It was wrong to say that, because the taxpayer was careless, it was impossible to establish suspension conditions. The judge said it was 'only because he was careless that he may become entitled to have his penalty suspended'.

The judge agreed with the taxpayer that a requirement to keep a schedule of interest received would be 'a practical and measurable condition' which should help the taxpayer achieve error-free returns in future. He ordered HMRC to suspend the penalty. Although the tribunal did not have the power to set the conditions, the judge suggested that the taxpayer should have to instruct a firm of qualified advisers to prepare his next return and that the firm should maintain a spreadsheet with details of his savings accounts and interest paid.

On the amount of the penalty, although it was to be suspended, the tribunal said:

'The mere fact that there is an error in a tax return does not mean that a taxpayer has been careless. Moreover, on the basis of the material we have seen, we consider that [he] would have had a strong, arguable case that his behaviour was not careless. To levy a penalty of £368.65 on a taxpayer who heretofore has had a good compliance record over many years, and then to refuse to consider suspension of those penalties, does not reflect well on HMRC.'

The taxpayer's appeal was allowed.

Comments - Although the taxpayer in this case did not appeal against the inaccuracy penalty, only its suspension, based on the material the FTT had seen, it considered that the taxpayer would have had a strong arguable case that his behaviour was not careless. The FTT also commented that to levy a penalty of £368.65 on a taxpayer who before then had a good compliance record over many years, and then to refuse to consider suspension of those penalties, did not reflect well on HMRC. It is also interesting that although at the beginning of the hearing both parties submitted that the hearing should be stood over to enable the parties to pursue Alternative Dispute Resolution (ADR), the FTT decided that it was in the interests of fairness and justice to proceed with the hearing and accordingly refused the postponement application.

P Steady v HMRC TC5225

Underpayment arising from use of wrong code

Summary – The FTT has dismissed an employer's appeal against HMRC's refusal to issue a direction under reg72 of the PAYE regulations to recover underpaid PAYE from the employee as the employer had not taken reasonable care to comply with the PAYE regulations.

An employee worked for the taxpayer from July 2011 until September 2012. As a result of the employer using the wrong PAYE code, the employee underpaid tax. HMRC claimed the sum from the employee, but he appealed, saying the employer should pay it because the underpayment had arisen from its error. The employee had written to HMRC twice to explain the employer was using an incorrect code.

Decision:

The First-tier Tribunal noted that HMRC had accepted the employer's error in applying the wrong code had been made in good faith. However the employer had failed to take reasonable care when taking on the employee. It had not submitted a form P46, which it should have done in the absence of a P45 from the employee. If it was unclear, it should have checked with HMRC about the correct procedure. The judge said:

'As it is inherent in the PAYE system that the onus is on the employer to deduct and account for tax on employees' earnings, we would not expect a reasonable and prudent employer to assume that asking the employee for information and seeking to put the onus for providing the correct code on the employee suffices to comply with its PAYE obligation without seeking any further information from the available materials or assistance from HMRC.'

The taxpayer's appeal was dismissed.

Comments - This case examines the circumstances in which a direction may be made by HMRC for recovery from an employee of tax not deducted by an employer. The employer had failed to deduct sufficient tax on an employee's earnings by not following the correct new employee procedures of completing and submitting a P46 form and operating a 0T tax code. The FTT stated that this amounted to a failure to take reasonable care to comply with the PAYE regulations on the part of the employer. The appeal against HMRC's refusal to issue a direction for recovery from the employee was refused.

Paringdon Sports Club (TC5229)

Admissibility of an expert report

Summary - The FTT decided not to admit an expert report covering contested legal issues as evidence.

Deloitte had applied for permission to admit expert evidence on the insurance industry practice and regulation of payment protection insurance (PPI) mis-selling.

The issue in the appeal was whether services which Deloitte provided to a loan provider in relation to PPI policies, which the loan provider had sold, fell within the exemption for relevant related services performed by insurance brokers and agents under VAT Directive 2006/112 art 135(1)(a).

The expert evidence was a report by a chartered intermediary and a fellow of the Chartered Insurance Institute which, in Deloitte's submission, explained the complex regulatory framework applicable to insurance contracts. HMRC argued that the report gave views on the law and on interpretation of contract, which were contested issues and as matters of law were for submission, and that it sought to answer the very questions of VAT law which it was for the tribunal to decide.

Decision:

Having reviewed the case law, the judge in the FTT made the following four points.

1. Relevant evidence should be admitted unless there are compelling reasons not to. The prejudice to each party of respectively admitting / not admitting the evidence should be weighed. (*Mobile Export365* and *Atlantic Electronic*).

2. An expert's evidence of opinion is admissible because it is the product of a special expertise which the tribunal does not possess, or even if it does, which is not its function to apply (*Hoyle*).

3. Expert reports are not rendered inadmissible because they refer to legislation, matters of law or indeed the very issue before the court or tribunal. Tribunal panels (who are not lay finders of fact) can be credited with the ability to distinguish between inadmissible / admissible matters in a report and to know that they have to reach their own view on the legal question before them. (*JP Morgan Chase Bank*, and *Kennedy*)

4. Even if reports contain inadmissible expert evidence of fact they can be admitted and should be admitted without requiring excision particularly if the admissible / inadmissible evidence of fact is intertwined (*Hoyle*).

The FTT found that the report contained contested matters of law which were more efficiently addressed through submission rather than expert evidence. It added that the difficulty with simply excising the matters appropriate for legal submission and leaving the remainder was 'with the coherence of explanation and usefulness to the tribunal of what would remain of the report'.

The tribunal therefore rejected admission of those sections of the report which contained matters more appropriate for legal submission but permitted Deloitte to serve evidence covering the matters of fact that would otherwise be lost.

Comments – The FTT examined an expert report looking at what legal issues may be admissible. The FTT decided not to admit it as the legal issues were contested.

Deloitte v HMRC TC 5231

Validity of penalty for late filing

Summary - The Court of Appeal upheld the Upper Tribunal decision in favour of HMRC on daily late filing penalties in Donaldson in 2014.

Mr Donaldson had failed to file his return by 31 October 2011. On 18 December 2011 he had been sent a reminder stating that it was too late to file a paper return 'without having to pay a £100 late filing penalty'. It also stated that, if he failed to file his return by 31 January 2012, 'a £10 daily penalty would be charged every day it remained outstanding'.

Mr Donaldson filed his return on 1 May 2012. He was then sent a notice informing him that he had incurred a total penalty of £1,200 comprising £900 in daily penalties (under Para 4 Sch 55 FA2009); and £300 for filing the return more than 6 months after the due date (pursuant to para 5). Mr Donaldson appealed against the daily penalties.

Decision:

The first issue was whether HMRC had actually decided that the penalty was payable. HMRC's case was that it had taken a decision within the meaning of para 4(1) (b) by taking the high policy decision in June 2010 that all taxpayers who were at least three months late in filing their returns would be liable to a daily penalty. The Court of Appeal found that this generic policy satisfied the requirement of para 4(1)(b).

The second issue was whether HMRC had given notice of the penalty to Mr Donaldson. The Court of Appeal found that HMRC had given notice in advance of his failure to file the return after the end of the three-month period. This advance notice complied with the requirement of para 4(1)(c).

Finally, the Court of Appeal found that the notice had been valid despite not specifically stating the 'period in respect of which the penalty was assessed' as required by para 18(1)(c). Although the period was not stated, it could be worked out without difficulty.

Comments - The Court of Appeal decided that: (1) HMRC’s policy decision to charge daily penalties to all taxpayers whose returns were more than three months late satisfied the decision requirement in FA 2009; (2) HMRC’s SA Reminder and form SA326D satisfied the notification requirements of para. 4(1)(c); and (3) although HMRC’s penalty assessment failed to state the period over which the penalty was incurred as required by para. 18(1)(c) the assessment was saved by s114(1) TMA 1970. It is understood that lots of cases have been on hold awaiting this decision. It considers whether HMRC’s policy and process for assessing daily late filing penalties meets with the requirements of the legislation. The Court of Appeal decided that HMRC had met the decision and notification requirements, and although the assessments did not contain all the information required, as the defect was one of form rather than substance the assessments were not void.

K Donaldson v HMRC EWCA Civ 761

Was a mistake in a return a reasonable excuse?

Summary - The FTT said that a mistake in a return which had caused a processing delay was not a reasonable excuse.

Following a lease transaction, Birchgrove had submitted a land transaction return (LTR) and paid the SDLT due on 22 June 2015. However, the LTR had only reached HMRC on 11 August 2015, 39 days late, because it had contained a reference to a different client and a different transaction. HMRC imposed a penalty; and Birchgrove only found out about its error after submitting its appeal and as a result of a disclosure by HMRC. The issue was whether the unintentional error amounted to a reasonable excuse.

Decision:

The FTT accepted that the agent had made all reasonable efforts to find out why the form had not been received. However, inaccurate information caused processing issues for HMRC and could not provide taxpayers with a reasonable excuse.

Comments - The FTT considered that mistakes such as ticking the wrong box, sloppy arithmetic or giving inaccurate references do not constitute reasonable excuses. This case is likely to be relied upon by HMRC whenever taxpayers argue that a genuine error gives rise to a reasonable excuse.

Birchgrove v HMRC TC5247

Some penalties due - Reasonable excuse for late filing

Summary – The taxpayer was successful in part regarding reasonable excuse

The taxpayer filed his 2010-11 and 2011-12 tax returns late and incurred penalties of more than £4,450. The returns were filed in February 2015 and July 2014 respectively. He appealed on the ground of reasonable excuse. He was injured in a car accident in January 2014 as a result of which he was unable to attend to his tax affairs.

Decision:

The First-tier Tribunal accepted that this constituted a reasonable excuse for the period from January 2014 and quashed the penalties imposed in April and September 2014.

The taxpayer's appeal was allowed in part.

Comments – The decision is self-explanatory

M Baines-Stiller v HMRC TC5233

Could the taxpayer rely on a ruling?

Summary - The High Court found that a ruling given by HMRC in respect of the application of landfill tax (LFT) at one site was not intended for that site alone. It was a general statement as to the meaning and effect of the relevant legislation and could be relied upon for all the company's sites.

Biffa challenged HMRC's decision of October 2014 ('the contested decision'), reinstating a decision taken on 31 May 2012. The contested decision directed Biffa to treat as subject to landfill tax (LFT) the use of material in the construction of a 'regulation layer' at its North Herts site and other sites. Biffa contended that the contested decision was contrary to a previous ruling from HMRC, which Biffa had received in September 2009. HMRC argued that Biffa had failed to disclose all relevant facts before the ruling had been made. The issues were therefore the scope of the September 2008 ruling and whether it would be unfair to revoke it with retrospective effect.

The HMRC officer had said at the hearing: 'The statements made by me in relation to the North Herts site were not statements of policy.' The court found, however, that it was 'simply not possible to reconcile those assertions with the documents disclosed after the hearing. Those documents show that policy advice had been sought and given, that the ruling fully reflected that policy advice, and that at the time Mr Hart (the HMRC officer) knew that to be the case.'

Decision:

The High Court also found that the ruling was not limited to the North Herts site: 'the documents now disclosed utterly undermine any contention that HMRC intended to make a ruling that was exclusively site specific'. Furthermore, the ruling was clear, unambiguous and devoid of any relevant condition. Finally, there had been no material non-disclosure by Biffa.

Comments - This case raises a number of important issues concerning the application of landfill tax but, most significantly, considers the matter of whether, and to what extent, a ruling by HMRC can be relied upon by the recipient. Judge, Sir Kenneth Parker, was scathing in his criticism of HMRC's attempt to apply a narrow scope to the representation when no such narrow scope was intended at the time the ruling was given. HMRC put forward an interpretation that was wholly inconsistent with what, at the relevant time, should have been the effect of the representation in question, action which the judge considered to be both offensive to justice and unlawful.

Biffa Waste Services Ltd (Biffa) v R & C Commrs EWHC

Tax impact of Brexit (Lecture B968 – 12.36 minues)

VAT

The VAT system is unlikely to change for at least two years and when it does change there should not be any major changes as our VAT law is independent of the EU. We have the VAT Act 1994, Statutory Instruments, HMRC Briefs and Notices. While the UK VAT law has been drafted from the Principal VAT Directive, going forward the UK law is likely to be the supreme authority with the UK courts being the supreme court.

If anything the UK should have more flexibility with the ability to expand zero rating and lower rating.

VAT on international services

Overall the liability should not change significantly:

- B2B services to EU businesses will remain outside the scope of UK VAT
- Buying in services from the EU will still be subject to a reverse charge in the UK
- B2C Schedule 4A Para 15 services to non-EU recipients will need further consideration

The main changes will be on the compliance side as EC Sales Lists for services will no longer be required.

The MOSS simplification will switch to the Non-EU version and so will still be available.

VAT on international goods

The VAT regime should not change a great deal in terms of liability with:

- Zero rated dispatches becoming zero rated exports
- Buying goods from the EU will become an import rather than acquisition

Again it is the compliance arrangements that are likely to have the biggest impact with import VAT at the point of entry and we may need to consider a Duty Deferment scheme. Additionally we will need exports procedures to be in place when selling to the EU. On the plus side neither the EC Sales Lists nor Intrastats will be needed for intra EU trading in the future.

Customs Duties

These will be a major factor in our Brexit negotiations, as the UK will cease to be part of the EU Customs Union. We will need our own law and will be able to set our own rates but duty will become chargeable on the movement of goods to and from the EU. This could lead to increased costs and extra formalities.

Bilateral trade agreements are likely to reduce the impact of leaving the EU but they will take time to negotiate. Hopefully, with countries like Germany, France and Belgium having significant trade with the UK, favourable agreements can be reached. With immigration being a major factor in the UK voting to leave the EU, it is unlikely that other options like being a member of the EEA or EFTA will be considered as they come with the free movement of people.

Other indirect taxes

The EU influence on excise duty would cease but there is already a lot of flexibility so it seems unlikely to change significantly.

Other indirect taxes are not government by EU law and so air passenger duty, landfill tax, climate change levy and aggregates levy should not change.

Direct taxes

These are subject to national rather than EU law but EU treaties do have an impact. These treaties authorise the European Council to issue Directives and a number of EU Directives have been implemented to assist intra EU trade and investment.

The most important of these are the:

- Parent-Subsidiary Directive
- Interest and Royalty Directive

These prohibit withholding tax taxes to be deducted on intra-group interest, dividend and royalty payments within the EU which are clearly important for overseas investment in the UK. We may need bilateral treaties to achieve the same effect. Some treaties are already in place and would simply need tweaking while others would need quite a bit of work.

The UK is a member of the G20, OECD and the WTO and this membership is independent from its membership of the EU so we will continue to benefit from treaties and other agreements that are already in place within these organisations.

Conclusion

No one really knows the full tax impact of Brexit.

VAT is going to need some compliance changes but the UK will have greater flexibility with VAT post Brexit.

Customs Duty is a concern but hopefully we will be able to negotiate favourable terms.

At a general practitioner level we should not many changes to income tax, corporation tax, CGT or IHT. International groups will see some changes but hopefully they will be for the better.

Deadline Dates

1 August 2016

- Due date of payment of CT liabilities for periods ended 31 October 2015 if not due by instalments.
- Outstanding 2014-15 SA tax returns now subject to a penalty of £300 or 5% of tax due whichever is higher (in addition to previous late filing penalties) on this date.

2 August 2016

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

5 August 2016

- Quarterly report by employment intermediaries for period 6 April to 5 July 2016 due by this date.

7 August 2016

- Due date for filing VAT return and making payment for 30 June 2016 quarter (electronic payment).

14 August 2016

- Due date for quarterly corporation tax instalment payment for large companies.
- Monthly EC sales list if paper returns used to be filed by this date.

19 August 2016

- Pay PAYE/CIS for month ended 5 August 2016 if by cheque by this date.
- Due date to file monthly CIS return.

21 August 2016

- Online monthly EC sales list due.
- Intrastat — supplementary declarations for July 2015 due.

22 August 2016

- Due date forPAYE/NIC/student loan payments if paid online.

31 August 2016

- Companies House must receive accounts of private companies with 30 November 2015 year ends.
- Companies House must receive accounts of public companies with 28 February 2016 year ends.
- Due date for CTSA returns for accounting periods ended 31 August 2015.
- Due date for annual adjustment for VAT partial exemption claims, May year end.
- Submit PAYE settlement agreement (PSA) figures to HMRC to enable final income tax and National Insurance liabilities to be advised for 19 October 2016 deadline by this date.

HMRC News

Finance Bill 2016 rested until September

An updated version of Finance Bill 2016 is now available, with amendments and new clauses from the committee stages included. All clauses from clause 40 onwards have been renumbered to accommodate the new clauses. The final House of Commons Report Stage is scheduled for 5 September 2016, following the parliamentary summer recess.

See http://bit.ly/29VvGoZ.

Changes to tax relief for residential landlords

The tax relief that landlords of residential properties get for finance costs will be restricted to the basic rate of Income Tax, this will be phased in from April 2017.

The amount of Income Tax relief landlords can get on residential property finance costs will be restricted to the basic rate of tax.

The changes will:

- affect you if you let residential properties as an individual, or in a partnership or trust
- change how you receive relief for interest and other finance costs
- be gradually introduced over 4 years from April 2017

Finance costs won't be taken into account to work out taxable property profits. Instead, once the Income Tax on property profits and any other income sources has been assessed, your Income Tax liability will be reduced by a basic rate 'tax reduction'. For most landlords, this'll be the basic rate value of the finance costs.

Who'll be affected

You'll be affected if you're a:

- UK resident individual that lets residential properties in the UK or overseas
- non-UK resident individual that lets residential properties in the UK
- individual who let such properties in partnership
- trustee or beneficiary of trusts liable for Income Tax on the property profits

All residential landlords with finance costs will be affected, but only some will pay more tax.

You won't be affected by the introduction of the finance cost restriction if you're a:

- UK resident company
- non-UK resident companies
- landlord of Furnished Holiday Lettings

You'll continue to receive relief for interest and other finance costs in the usual way.

What's included under the finance cost restriction

The finance costs that will be restricted include interest on:

- mortgages
- loans - including loans to buy furnishings
- overdrafts

Other costs affected are:

- alternative finance returns
- fees and any other incidental costs for getting or repaying mortgages and loans
- discounts, premiums and disguised interest

If you take a loan for both residential and commercial properties, you'll need to use a reasonable apportionment of the interest to work out your finance costs for the residential properties. Only the finance costs for the residential property business are restricted. This also applies if your loan was partly for a self-employed trade and partly for residential property.

Phasing in the restriction

The restriction will be phased in gradually from 6 April 2017 and will be fully in place from 6 April 2020.

You'll still be able to deduct some of your finance costs when you work out your taxable property profits during the transitional period. These deductions will be gradually withdrawn and replaced with a basic rate relief tax reduction.

You'll be able to use some of your finance costs to work out your property profits and use your remaining finance costs to work out your basic rate tax deduction:

Tax year	Percentage of finance costs deductible from rental income	Percentage of basic rate tax reduction
2017 to 2018	75%	25%
2018 to 2019	50%	50%
2019 to 2020	25%	75%
2020 to 2021	0%	100%

Other implications of the restriction

These reforms mean that the way taxable income is calculated will change and that may have other implications for some. For example, if you or your partner receive Child Benefit and your income is over £50,000 the High Income Child Benefit Charge may apply.

More information

These rules were announced at the Summer Budget 2015 and are contained in Finance (No. 2) Act 2015 as amended by Finance Bill 2016.
Changes to tax relief for residential landlords: how it's worked out, including case studies

Work out the tax relief for individual landlords and assess the impact of the finance cost restriction.
Deductible expenses for individual landlords

Guidance about your tax obligations and how to work out your rental income if you rent out properties in the UK.

Reform of the wear and tear allowance

Guidance about the relief allowing landlords of residential dwelling houses to deduct costs for replacing furnishings, appliances and kitchenware in the property.

Business Taxation

Appointment of receiver and group relief

Summary - The appointment of receivers over the whole property of a company constituted 'arrangements' which broke the group relationship for group relief purposes. The taxpayer companies were not under the same 'control', within the meaning in s154(3) CTA 2010.

The taxpayer companies included in amended corporation tax returns for the period to 31 May 2012, claims for group relief surrendered by a third company ('PH2L'). All three companies were 75% subsidiaries of the same ultimate parent company.

PH2L had been placed into receivership in June 2011, effected by the appointment by the bank of a Receiver over the whole of PH2L's property. The Debenture under which the appointment was made gave the bank fixed and/or floating charges over the whole of the property, assets and undertaking of PH2L (the floating charge crystallising into a fixed charge on appointment of a Receiver); and gave the Receiver powers (inter alia) to carry on the business of PH2L.

The statutory Notice of Appointment of the Receiver recorded that the Receiver's appointment was over 'the whole of the property of the company' (as opposed to part of such property).

By closure notices issued in December 2014, HMRC denied the claims to group relief. The taxpayers appealed.

Decision:

The judge said the point in dispute was whether there were relevant 'arrangements in place', within s154 CTA 2010, so as to break what would otherwise be the group relationship between the taxpayer companies and PH2L.

'Arrangements' would be within s154 if (inter alia) they had the effect that: 'At some time during or after the current period a person (other than the first or second company) has or could obtain, or persons together (other than those companies) have or could obtain, control of the first company but not of the second company.'

The meaning of 'control' for this purpose was found in s1142(2) CTA 2010:

'the power of a person (P) … to secure that the affairs of [a company] are conducted in accordance with P's wishes.'

With regard to s the construction of these statutory provisions, the judge said:

a) He considered the taxpayers could not call in aid the rule in Pepper v Hart in 1992, since there was no clear Ministerial statement directed to the matter in issue; and in any event it would not in his view be an 'absurd' outcome if the appointment of a receiver had the effect of degrouping a company;

b) Whilst it was appropriate to take marginal notes to a statutory section into some account, the note in this case ('Arrangements for transfer of member of group of companies, etc') did not assist in the interpretative exercise. The use of the concluding 'etc' showed the note was to be illustrative at best;

c) Whilst it was also appropriate to use Explanatory Notes to an Act as an aid to interpretation, the Notes in this case did not give any real assistance to assessing the contextual sense.

In the judge's view the purpose of the statute emerged clearly from the words used. The requirement in s154 was that claimant and surrendering companies be under the same control – no more, no less. There was nothing in the section, or in the Part of the Act in which it fell, to suggest the purpose of the section was anti-avoidance (and thus to meaning that the section had to be read narrowly).

A wide approach was also to be taken to the term 'arrangements'; they did not need to be bilateral, and the appointment of the Receiver pursuant to the Debenture constituted 'arrangements'. And in the judge's view, the effect of the arrangements was that the Receiver had 'control' of PH2L: the whole of the property was put into the hands of the Receiver, who had very extensive powers – thus the entire affairs of PH2L, read practically, were put into the hands of the Receiver. Whilst the directors of PH2L did remain in office, their powers of management were rendered incapable of being exercised. The Receiver replaced the board as the person having the authority to exercise the company's powers.

Accordingly, once the Receiver had been appointed, the shareholders of PH2L did not have 'control' of PH2L; the effect of the appointment of the Receiver over the whole of the property of PH2L constituted 'arrangements' unders 154(3); PH2L was no longer a member of the same group as the taxpayer companies in the accounting period ended 31 May 2012; the taxpayer's appeals therefore fell to be dismissed.

Comments - The judge said that in this case (and in the absence of any witness statements or oral evidence) he could not see 'any relevant powers outside the scope of the receivership, nor any suggestion that the receivers had disavowed any of their powers', so as to permit any realistic argument that some sufficient control of PH2L's affairs, to satisfy the statute, remained vested in the directors or shareholders of PH2L. It seems there may be scope in some 'receivership' cases, but on an appropriate different set of facts, to argue that the group relationship has not been broken under this 'control' head.

Farnborough Airport Properties Company and Farnborough Properties Company v HMRC TC5184

Nature of a single property transaction

Summary – The FTT dismissed Mrs Stayton's appeal that the purchase and disposal of a property was an adventure in the nature of a trade finding that the property was held as a capital asset and was therefore subject to capital gains tax on disposal. The FTT also dismissed Mrs Stayton's appeal against the penalties raised under s7 TMA 1970 for failure to notify and under s95 TMA 1970 for submitting an incorrect return. The FTT further increased the amounts of the penalties by determining lower mitigation percentages than those awarded by HMRC

The taxpayer was married to a property developer. In April 2005, she bought a property. After renovating it, she sold the house in May 2007. She said, although she had originally planned to occupy the house, the venture had been a trade. HMRC said she had held the property as a capital asset and capital gains tax was due on the proceeds. It also imposed penalties for failure to notify chargeability and submitting an incorrect return. The taxpayer appealed.

Decision:

The First-tier Tribunal found as a fact that the taxpayer had had no intention of developing the property as an adventure in the nature of a trade. The judge referred to the badges of trade which she used as a 'common-sense guidance'. Viewed as a whole, although the taxpayer had bought the house with a view to living in it, she changed her mind after a dispute with the neighbours. It was a single transaction and unrelated to any trade the taxpayer carried on. The deal was financed by a loan to the husband's property development company which undertook the refurbishment — the taxpayer had no involvement with it. She had no more involvement than 'that of any owner who asks a third party to renovate his home'.

The house was held as a capital asset and subject to capital gains on disposal.

The tribunal upheld the penalties and decreased the mitigation allowed by HMRC on the ground that the amount of tax involved was substantial.

The taxpayer's appeal was dismissed.

Comments - In this case, Mrs Stayton realised a chargeable gain on the disposal of a property which she had purchased with the intention of it becoming her main home but she had then changed her mind and decided not to move in after a boundary dispute with neighbours during renovation works. Mrs Stayton initially failed to disclose the gain to HMRC and then, having filed a return declaring the capital gain, had subsequently amended the return to claim the transaction had been an adventure in the nature of trade once she became aware she could not claim a deduction for interest costs in a capital gains tax computation. The FTT found that the transaction was not a trade and dismissed her appeal. The FTT also dismissed her appeal against the failure to notify and inaccuracy penalties as well as increasing the penalties to reflect lower mitigation percentages than had been awarded by HMRC. The case also provides commentary on the interaction between multiple tax-geared penalties and calculation of the penalty limit where more than one tax-geared penalty is raised in respect of the same tax.

R Stayton v HMRC TC5104

Dealers' partnership profits

Summary – The FTT found that the taxpayers' costs of purchasing partnership interests were deductible revenue expenses in the sole trades only.

The taxpayers were financial dealers in the Investec group. They participated in transactions designed so they could exit from leasing partnerships, ie those in which all the capital allowances had been taken so that rentals would be taxable in full, without being taxed on rental income or balancing charges. They said they should 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 while they were the relevant partners.

HMRC said the relevant costs were non-deductible, or the taxpayers should be taxed on the net profits in their respective sole financial trades as well as on the entire partnership profits.

Decision:

The First-tier Tribunal described this case as 'very interesting and difficult'. It decided the taxpayers had been conducting two trades. One was the sole financial trade and the other their share of the partnership profits. The taxpayers' costs of purchasing partnership interests were deductible revenue expenses in the sole trades only.

Having reached those conclusions, the tribunal had to decide how the calculations should be made. It ruled that it was appropriate to deduct from the gross income the amount already taxed under s114 ICTA 1988, so that the sole trade computations would generate expenses without matching income.

On a procedural point concerning closure notices, the tribunal said HMRC was not precluded from raising other points in the covering letter accompanying the notices.

The decision was given in principle with the tribunal saying there was no 'clear-cut conclusion as to who won' the appeals.

Comments – The Tribunals comments on their deliberation and their comment on no clear cut conclusion are self-explanatory.

Investec Asset Finance plc; Investec Bank plc v HMRC TC5111

Set-off of corporation tax loss against income tax profit

Summary - The FTT has allowed English Holdings (BVI)'s appeal against HMRC's refusal of its claim to offset a loss arising from a trade carried on through a permanent establishment (PE) in the UK (which would have been subject to corporation tax if profitable) against profits arising from a lettings trade, chargeable to income tax as not carried on through a PE. The FTT found that there was no requirement in s64 ITA 2007 that for a loss to be offset against general income it had to arise in a trade which was charged to income tax and no purposive reading was possible so as to block the appellant's claim.

*However, the FTT dismissed the company's appeal against the tax geared late filing penalty on the basis that had a correct return been filed on time it would have disclosed a liability to tax because the loss relief was not available until the following period***.**

The taxpayer had a permanent establishment in the UK through which it carried out its activity of trading in UK land. In the year to 31 March 2011, it made a trading loss of more than £2m.

It also owned several investment properties in the UK on which it earned rental income. This letting business was not carried on through a permanent establishment, rendering the company liable to UK income tax on the profits arising from this business. It claimed to set off the loss arising from its trade against the profits of the letting business. HMRC refused, saying the taxpayer was not entitled to relief under s64 ITA 2007 because the legislation did not permit a claim on a loss that, had it been a profit, would have been subject to corporation tax. It raised an assessment accordingly. The taxpayer appealed.

Decision:

The First-tier Tribunal looked first at whether a corporation tax loss could be set off against an income tax profit. It decided that, taken literally, the legislation entitled the taxpayer to set a corporation tax loss against income subject to income tax. Although the legislation did not permit income tax losses to be set against profits subject to corporation tax (s36(3) CTA 2010), the income tax legislation provided no 'mirror provision'. There was no requirement in s 64 for the loss to arise in a trade that was charged to income tax; the loss had only to arise in a trade that had taken place in a year for which income tax was charged. The judge said:

> 'It is not obvious to me that parliament intended that taxpayers in the unusual position of having two trades, one subject to corporation tax and one subject to income tax, would not be able to set a corporation tax loss against an income tax profit (although it is clear they could not set an income tax loss against an corporation tax profit). Ordinary taxpayers are able to set losses arising in one trade against profits arising in other trades.'

The taxpayer also appealed against a penalty for the late filing of its return. The tribunal said the taxpayer had submitted the return late and its view on the law on its right to claim income tax relief was irrelevant. The penalty was therefore due.

The taxpayer's appeal against the assessment was allowed but the appeal against the penalty was dismissed.

Comments - In this case a BVI company claimed to offset a loss arising on a trade carried on through a permanent establishment (principally, a corporation tax loss) against income tax profits of a trade not carried on through a PE (and, therefore, subject to income tax, not corporation tax). The FTT has allowed the claim finding that s64 ITA 2007 did not restrict loss relief to income tax losses only and no purposive reading could be applied so as to block the company's claim. However, as the company had filed its return late, which, had it been filed on time would have shown a liability to tax (albeit refunded in the next period), the FTT dismissed the appeal against the late filing penalty finding that it was properly due based on the liability that ought to have been declared on the return.

English Holdings v HMRC TC5189

Loss streaming is necessary - Corporation tax losses on transfer of trade

Summary - The UT found that s 343 only allowed loss relief in relation to the continued trade of the predecessor.

L Ltd carried on a retail trade. It acquired the shares of C Ltd, which carried on a similar business. The trade of C was transferred to L and its stores rebranded so that all of the stores traded under the L name. C had accumulated losses of about £3m. L claimed relief for those losses against the profits of its enlarged business in the year after acquisition. HMRC challenged the use of the losses. The First-tier Tribunal found in favour of the company and HMRC appealed.

Decision:

The Upper Tribunal said the First-tier Tribunal had made an error when it decided that the successor should be treated as having incurred the losses transferred to it from C under s343 TA 1988. That had led it to conclude that the transferred losses could be set against the entirety of L's profit. That outcome would put L into a better position than C would have been had it continued to trade. The legislation was not designed to do that. Section 343(3) allowed the brought-forward losses from C's trade to be set against its future profits, albeit that trade was now being carried on as part of L's larger trade. Thus, L's results had to be streamed to differentiate the elements attributable to C's business and those from L's business.

Counsel for HMRC noted that this was the first case on the point since the legislation was introduced in FA1965. This form of acquisition followed by a hive up was common, which strongly suggested that, in practice, the legislation had not led to any insuperable difficulties. The Upper Tribunal also rejected the First-tier Tribunal's argument that the approach adopted by the taxpayer was 'more closely aligned to commercial reality'.

In the end, it was a matter of statutory construction. Although at first sight s 343(3) might appear somewhat obscure, there was no doubt about its correct interpretation.

The First-tier Tribunal's decision was therefore wrong and HMRC's original closure notice was restored.

HMRC's appeal was allowed.

Comments – The comments when the case was won by the taxpayer in 2015 included: This legislation has never been particularly clear on the matter of loss streaming in circumstances such as these therefore any clarification that gives taxpayers greater certainty is to be welcomed particularly on such an important point of principal with wide application to other taxpayers. HMRC may be concerned about the implications of the judgement for loss-buying situations therefore a further appeal or a re-write of the legislation to achieve HMRC’s preferred interpretation should not be ruled out. The provisions of s343(3) ICTA 1988 are now re-enacted in s944 CTA 2010 and, whilst the wording has been modernised and subtly altered as part of the tax law re-write project, inherent uncertainties about the profits against which losses can be relieved still remain. As can be seen the FTT decision has been overturned.

HMRC v Leekes Ltd, Upper Tribunal

The time line for loss relief

Summary – The FTT found that Corporation tax relief for an earlier loss must be given priority over relief for a later loss.

Countryfield had made profits in the 2005 and 2006 accounting periods and losses in the 2007, 2008 and 2009 periods. It was agreed that the loss for the 2007 period had been properly carried back to be set off against the 2006 period, leaving £48,445 profit for the 2006 period unrelieved.

The issue was the priority in which losses for corporation tax purposes can be set off against the profits of earlier accounting periods under s393A 1988, and more specifically the meaning of the phrase 'subject to…any relief for an earlier loss' in s 393A(1). HMRC contended that relief was to be given for losses in chronological order so that a loss for an earlier accounting period should be relieved before a loss of a later accounting period.

Decision:
The FTT agreed with HMRC, finding that s 393A(1) referred to a loss incurred earlier and that the provision did not refer to the order in which claims for loss relief were made.

Comments - That the amount of losses that can be deducted from profits of an earlier accounting period was found to be subject to relief for losses of an earlier period is an uncontroversial decision and, except for situations involving accounting periods of less than one year, the practical relevance is likely to be limited to accounting periods ending between 23 November 2008 and 24 November 2010, being the timeframe within which the temporary three year loss carry back period was permitted. This case highlights one of the practical difficulties of applying loss relief when several accounting periods are involved

Countryfield Village Homes v HMRC TC5220

Manufactured Overseas Dividends & EU principle of free movement of capital

Summary - The First-tier Tribunal has held that the UK tax treatment of manufactured overseas dividends (MODs) does not breach EU law that seeks to prevent any restriction on the movement of capital.

The Appellant was a corporate trustee which had responsibility for managing the British Coal Staff Superannuation Scheme. It had claimed repayment of withholding tax in connection with stock lending transactions.

Typical stock lending arrangements involve institutional investors transferring legal and beneficial ownership of shares to a borrower on terms that, at the end of the stock loan, the shares or an equivalent number of shares will be transferred back to the lender. The contractual terms of a stock lending transaction involve an obligation on the borrower to provide the lender with a payment of equivalent value to any dividends paid during the term of the loan. These payments are known as 'manufactured dividends'; and, when they relate to dividends derived from overseas shares, as 'manufactured overseas dividends'.

In the relevant tax years, the UK imposed no charge to UK income tax or corporation tax on manufactured dividends paid in respect of shares in UK companies; however, it did impose a withholding tax on MODs where a withholding tax would have been imposed by the country of origin had the MOD been an actual dividend.

The issue was whether EU law permitted the UK to charge withholding tax on MODs when it did not charge any tax or equivalent tax on manufactured dividends in relation to UK shares.

Decision:

The FTT agreed that the stock-lending transactions involved a movement of capital since, under the terms of the stock lending agreement, there was a transfer of legal and beneficial ownership of the shares to the borrower, but did not consider that the MOD regime amounted to a restriction on the movement of capital. This was because the MOD regime simply ensured that manufactured overseas dividends were treated in the same way as actual overseas dividends.

As a general rule, overseas dividends are subject to tax in the jurisdiction in which they are paid and in the jurisdiction in which they are received (juridical double taxation). Juridical double taxation is a matter for the shareholder's state of origin and EU law principles are only applicable if there is some discrimination. Thus the UK is not bound to give relief for the overseas withholding tax (although it does in fact do so, to the extent that there is a UK tax liability against which it may be offset).

The FTT also considered that, if the MOD regime did involve a restriction on movement of capital, it fell within the permitted justifications in art. 58 (which allows restrictions on movements of capital in specified circumstances). In this case it could be justified on the grounds of prevention of tax avoidance (a tax exempt lender such as a pension fund could otherwise lend shares to a taxable borrower purely in order to enable the tax credit to be recovered), and on the grounds that it preserved the coherence of the UK tax system (by treating manufactured dividends in the same way as actual dividends).

Comments - A number of other pension funds seeking to obtain repayment of withholding tax on manufactured overseas dividends also contributed to the costs of this appeal, which may therefore be regarded as a test case.

Coal Staff Superannuation Scheme Trustees v HMRC TC5203

VAT

Best judgment to assess a difference on the company's accounts

Summary – The HMRC officer used best judgement where there were differences in output tax

An HMRC compliance officer compared the turnover of the taxpayer's accounts with the output tax on its VAT returns for the years ending 31 July 2009 to 2011. He raised an assessment for £27,768 because more sales were recorded in the accounts than on the VAT returns. It was reduced to £17,614 because only the final quarter of 2009 was in time under the four-year assessment rule (s77 VATA 1994). The assessment was raised on the basis of s 73(1) which gives officers the power to 'assess the amount of VAT due … to the best of their judgment'.

Decision:

The taxpayer's accountant was not available to explain the differences to HMRC or the tribunal because of a 'personal tragedy', but the tribunal said the Revenue officer had done everything expected of him to produce a fair assessment. He had taken account of the company's zero-rated sales and given the taxpayer the opportunity to explain the differences.

Although sympathising with the company that it had been unable to establish the correct figures, the taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, commented: 'It is good practice for accountants to do a turnover versus outputs check each year when annual accounts are produced, and also to agree the VAT debtor or creditor balance in the nominal ledger to the liability shown in box five of the VAT return. The latter check is usually easy to do because most businesses have VAT returns that coincide with their financial year. As this case illustrates, it can be very difficult to back pedal and resolve the reason for differences that happened many years ago.'

Wholesale Clearance UK Ltd v HMRC TC5027

Goods or services? - Request to amend date of VAT registration

Summary – The Tribunal found in favour of HMRC regarding the non-revision of a date of registration

In 2008 the taxpayer began building a commercial property. It ran out of funding, so sold the property, which was 90% complete, in early 2012. The sale was standard rated because it was non-residential and less than three years old.

The company submitted an application for VAT registration in December 2011 to be effective retrospectively from 31 March 2011. The director expected this would enable all pre-registration input tax to be recovered on costs incurred since 2007 (reg 111 of the 1995 VAT Regulations).

However, because the cost of construction services and materials provided by builders are treated as services, only the six-month window applies. Businesses have up to four years to reclaim the VAT on goods. As a result, HMRC reduced the input tax of £121,833 claimed on the February 2012 VAT return to £1,578.

The taxpayer therefore requested that the effective date of registration should be backdated to 31 March 2008, but HMRC refused.

The taxpayer appealed.

Decision:

The First-tier Tribunal found that the taxpayer's misunderstanding of the different treatment of goods and services was genuine. On that basis, HMRC's refusal to accept the revised date of registration was not reasonable. However, the tribunal decided the Revenue's decision would 'inevitably have been the same' because 'there was a delay in making the application to backdate the effective date of registration (which was not made until 5 September 2014 nearly three years after the application for registration was made)'. Further, the request to backdate had not been made before the due date of the first VAT return.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, said: 'This case highlights the importance of giving full care and attention to deciding the correct date of VAT registration when the registration is voluntary. Although a taxpayer can choose his own date of registration with scope to backdate by up to four years, once a date has been approved by HMRC it is difficult for a business to ask for it to be amended. In reality, the only time when this would be allowed is if a genuine error occurred in the original application, such as typing the wrong month or year on an online application.'

He said the other main learning point from the case was that, just because construction costs are capitalised to the balance sheet for accounting purposes, 'they are not necessarily classed as “goods” for VAT purposes'.

Max Investments Ltd v HMRC TC5063

Failure to notify a change in legal entity

Summary – The Tribunal found heavily in respect of the taxpayer for a technical failure and slated the behaviour of HMRC

JB ran his business as a sole trader and was registered for VAT. He took on his son as a business partner in November 2012. This was a transfer of the business as a going concern but JB failed to tell HMRC of the change in legal entity until July 2014. He continued to submit VAT returns and pay tax as a sole trader during this period.

HMRC treated the notification in 2014 as a late registration by the partnership of more than 12 months. It issued a penalty based on 18% of the tax due by the partnership in this period.

The penalty was mitigated by a further 70% to reflect the fact that the VAT returns and tax for the period(s) in question had been submitted by the sole trader registration so there was no loss of tax but that two of the six returns were submitted late.

Decision:

The First-tier Tribunal said the error attracting the penalty:

'was one of the merest technicality, a minor administrative hiccup, involving minimal culpability, causing no loss to the revenue, and no administrative inconvenience to HMRC.'

Further, after the taxpayer voluntarily disclosed his error, the protracted way HMRC had dealt with the case caused 'significant inconvenience and expense' to the taxpayer and 'the general taxpayer considerable expense far beyond the amount of the penalty'.

The tribunal reduced the penalty to £100 by giving a 90% discount rather than 70% on the basis that the taxpayer had submitted only one late VAT return during the period in question. The 18% penalty was reduced to 12.5% to reflect the fact that more help had been given to HMRC than it had recognised, and the figure assessed by the department for the potential lost revenue was reduced from £10,879 to £8,080. So the overall penalty was reduced from £582 to £100.

The taxpayer's appeal was allowed in part.

Comments - Neil Warren, independent VAT consultant, said: 'Another concern highlighted in this case is that HMRC initially showed a surprising failure to engage in correspondence with the taxpayer and to consider the legitimate points raised by his accountant. In reality, the penalty system based on taxpayer behaviours is not intended to penalise this type of oversight. It is hoped that the critical comments of the tribunal will make HMRC more cautious in the future — a lot of time wasted for all parties could have been avoided.'

J & W Brown V HMRC TC5101

Input tax on taxable supplies treated as exempt

Summary - The Upper Tribunal dismissed the company's appeal against the decision of the FTT in 2014 that a taxable person receiving supplies of postal services, which were wrongly treated by Royal Mail as exempt, was not entitled to input tax credit in respect of those supplies.

Zipvit supplied vitamins and minerals by mail order. It used Royal Mail for this and to distribute advertisements. Royal Mail and HMRC believed that the supplies made by Royal Mail were exempt. In April 2009, the Court of Justice of the EU ruled in *R (on the application of TNT Post UK Ltd) v CRC (Case C-357/07)* [2009] STC 1438 that the postal exemption did not apply to individually negotiated supplies. As a result, it was accepted that the services supplied by Royal Mail to Zipvit were taxable. Zipvit then claimed the input tax on the supplies.

This raised two questions. First, whether VAT was 'due or paid' under the Principal VAT Directive, Art 168(a), so as to entitle Zipvit to deduct input tax. Second, whether the lack of invoices from Royal Mail put an end to Zipvit's claim when HMRC had a discretion to direct otherwise.
Decision:

The First-tier Tribunal agreed with HMRC that input tax could not be claimed and that invoices would, in any event, have been required. Zipvit appealed.

Mrs Justice Proudman in the Upper Tribunal said the VAT had to be 'due or paid' by the customer to the supplier. But this did not decide the matter because it was 'academic' given her view on the invoices question.

The judge said, if input tax were to be deducted, the supplier has to issue a VAT invoice to the customer showing the VAT charged. Zipvit held no VAT invoices and therefore had no right to deduct input tax unless HMRC exercised its discretion to admit other evidence of the charge to VAT. She said HMRC had been correct to consider why no VAT invoice was held. The reason was that the supply was treated as exempt. The ECJ has said that the purpose of the right to deduct input tax was to remove the burden of VAT from the undertaking. As the First-tier Tribunal said: 'Why should HMRC pay a refund out of public funds where it is not legally obliged to do so and such repayment would represent a windfall for the appellant rather than compensation for real loss?'

Mrs Justice Proudman concluded that HMRC had not been obliged to consider other evidence of the charge to VAT.

The taxpayer's appeal was dismissed.

Comments - As the lead case in the long-running 'postal services' dispute, this decision affects those who made similar claims or who are waiting to claim. Since VAT of about £1bn rests on the outcome of this case, there may be a further appeal. The UT agreed with the following statement from the FTT: 'Why should HMRC pay a refund out of public funds where it is not legally obliged to do so and such repayment would represent a windfall for the appellant rather than compensation for real loss?'

Residual VAT on overheads

Summary - The Upper Tribunal dismissed HMRC's appeal against the decision of the FTT and confirmed that a combined method for calculating recoverable input VAT on Imperial College's overhead expenses that was agreed by HMRC for the purpose of earlier (3 year time limited) claims was not ultra vires and was a PESM which HMRC was bound by in respect of the later Fleming *claims submitted in respect of the same expenses going back to 1973/74*

The taxpayer claimed a repayment of residual input tax on the proportion of overheads incurred by the college's academic departments. A dispute arose concerning the basis on which the net VAT originally paid for the relevant years was calculated.

The college said the calculations of recoverable VAT were made under a partial exemption special method (PESM) agreed with HMRC. The Revenue said they were a compromise of claims made by the college in respect of specific accounting periods.

The First-tier Tribunal preferred the taxpayer's argument. HMRC appealed.

Decision:

The Upper Tribunal said the agreed method was a single formula which combined attribution of input VAT between business and non-business activity with input tax between taxable and exempt supplies. It did so in a 'convenient and pragmatic' way and had been agreed as a PESM. Further, HMRC had the authority to approve it under the VAT Regulations 1995/2518, reg 102.

HMRC's appeal was dismissed.

Comments - In this case, the Imperial College submitted *Fleming* claims in respect of overhead expenses going back to 1973/74. HMRC had already agreed a PESM for calculating the recoverable input VAT in respect of an earlier claim for the same expenses. The earlier claim, however, had gone back only three years as it preceded the disapplication of the three year time limit by the case of Fleming (t/a Bodycraft) v R & C Commrs in 2008. The FTT had found that HMRC were bound by the earlier PESM agreed but HMRC had appealed on the grounds that the earlier PESM was ultra vires and in fact was a compromise of the earlier claims. HMRC wanted to re-negotiate the claims afresh applying a different calculation method (which would ultimately result in a lower amount of input VAT being recoverable). The UT has confirmed the FTT's decision, the PESM was not ultra vires and HMRC were bound by it.

CRC v Imperial College of Science, Technology and Medicine, Upper Tribunal

Reduction in consideration

Summary - The UT held that Iveco's 2011 claim for VAT repayment relating to VAT overpaid before 1990 was time-barred.

Iveco Ltd ('Iveco') is the representative member of a VAT group which includes companies that distribute and sell commercial vehicles. This case concerns whether a claim submitted to HMRC in November 2011 by Iveco for a repayment of £73m in respect of VAT accounted for on rebates to purchasers of vehicles between 1 January 1978 and 31 December 1989 ('the claim period'), was time barred. In 2012, HMRC rejected the claim on the ground that it was out of time, being outside the 4 year time limit in s80(4) VATA 1994.

Iveco appealed to the FTT. The FTT decided that Iveco's claim was not subject to the time limit in s. 80(4), or otherwise time-barred, subject to the issue of whether Iveco's EU law right had expired. This latter issue was deferred pending the release of the judgment of the Court of Appeal in R & C Commrs v British Telecommunications plc in 2014. Following the release of the judgment, the FTT held that 'there is no requirement under EU law that Iveco's claim be brought within a reasonable period after the assumed price reduction that led to the overpayment of VAT.' The FTT allowed Iveco's appeal.

HMRC appealed to the UT challenging both aspects of the FTT's decision.

Decision:

The Sixth VAT Directive (SI 77/388), art. 11(C)(1) which was in force throughout the claim period, provided that where the price of a supply is reduced after the supply has taken place, the value of the supply must be reduced accordingly under conditions laid down by the member state. Article 11(C)(1) was not implemented into UK law until 1 January 1990, when VAT (Accounting and Records) Regulations 1989 ('the 1989 Regulations'), reg. 7 came into force. It was common ground that the article had direct effect, such that Iveco could rely on it to reduce the value of its supplies.

The Finance Act 1989 ('FA 1989'), s. 24 (which became s80 VATA 1994) came into force on 1 January 1990 and provided a 6 year time limit for recovering overpaid VAT. This time limit was reduced to 3 years with effect from 18 July 1996. Following the decision of the House of Lords in Fleming (t/a Bodycraft) v R & C Commrs in 2008 a new transitional period was introduced which provided that the 3 year time limit did not apply to claims for VAT overpaid in VAT accounting periods that ended before 4 December 1996, provided that the claim was made before 1 April 2009 ('the Fleming window'). The 3 year time limit was extended to 4 years with effect from 1 April 2009.

A central issue in the dispute was the question when Iveco's directly effective rights first gave rise to a relevant overpayment of VAT. Was it when the original price was reduced and payment made by Iveco or was it when the claim to a VAT refund was made?

Iveco's position was that, unless and until it made its claim to assert its directly effective rights under EU law, there could be no relevant 'claim' for the purposes of s80 VATA 1994 and therefore the time limits in s80 did not apply.

HMRC took the view that there is no need for Iveco to have asserted its directly effective rights before it can be said that there was output tax accounted for which was not output tax due or that there was VAT overpaid.

The UT held, reversing the FTT decision that:

1. S80 VATA 1994 applies on the basis that the reduction in the taxable amount and the consequent overpayment of VAT arose on the occasion of each price reduction; this disposed of the appeal, but if i) was wrong:–
2. All Iveco's claims relating to price reductions occurring before 1 January 1984 (6 years before FA 1989, s. 24 came into force) were time-barred prior to 1 January 1990 – s80 VATA 1994 does not apply in relation to such claims and does not revive them.

Comments - This is one of many cases concerning the application of the time limits for claiming overpaid VAT and is of interest as it concerned VAT paid before the introduction of the statutory time limits in UK law on 1 January 1990.

Deductibility of input tax incurred by bank in providing deposit account

Summary - The Upper Tribunal (UT) dismissed ING's appeal against the decision of the First-tier Tribunal in 2014 because ING made an exempt supply of 'banking services' when it accepted deposits and paid interest on them, so the VAT on its costs was irrecoverable.

The appeal related to the business of ING Direct, which involved taking cash deposits from retail customers and deploying the funds raised, mainly via the acquisition of bonds, in such a way as to make a profit. The dispute related to input tax incurred in connection with deposit taking. The substantial input tax had been incurred on expenditure on advertising campaigns, the construction of a head office and two call centres, IT systems and services, and employment of staff, including recruitment costs.

The main issue was whether the deposit taking activity involved a supply of services for consideration by ING or whether it was merely the lending of money.

Decision:

The FTT found that services were supplied depositors. Both *Newey* (Case C-653/11) and *Secret Hotels2 in the Supreme Court* in 2014 were authority for the proposition that contractual terms were the starting point; and the terms and conditions on which deposits were taken were consistent with services being provided to depositors as customers.

Furthermore, the commercial reality was that the depositors were customers; ING was providing banking services in the form of deposit accounts. The FTT also found that consideration was provided: 'The clear bargain between the parties was that if a deposit was made, the depositor would (in addition to the obligation to repay) receive in exchange interest together with the services.' Finally, that consideration could be expressed in monetary form.

Comments - This case may go further, as the dispute concerned input tax of £6,032,280. For VAT purposes, the facilities supplied by ING and used by depositors were not provided 'free of charge'. The vital question was to what supplies the input tax on the costs was attributable. The FTT had found (and the UT agreed) as a fact that ING had supplied exempt banking services to its depositors for a consideration. In any further appeal, ING may struggle to overturn that finding of fact.

ING Intermediate Holdings v HMRC] UKUT

Retrospective application of extra-statutory concession

Summary - The Court of Appeal dismissed the company's appeal from the Upper Tribunal and refused judicial review of HMRC's decision not to allow use of an extra-statutory concession on supplies of services by employment bureaux.

ELS supplied lecturers to colleges. It applied for judicial review of the decision of HMRC not to allow it to take advantage of an ESC (outlined in Business Brief 10/04 (BB10/04) and now withdrawn) which limited the amount of VAT that a business was required to charge when seconding its own staff. The concession applied provided that the client paid the salaries of the staff supplied directly to the personnel involved.

It meant that employment bureaux which provided self-employed staff, as principals, to their hirer clients could opt to be treated as agents and so limit the VAT payable for their services to the commission element of their charges.

ELS had restructured its business in 2006 by establishing PNL as an employment bureau which would take over the supply of lecturers to the colleges. It continued to supply some colleges, and HMRC considered that ELS's supplies were non-exempt educational services supplied by a non-eligible body. The aim of the arrangements was that PNL would be able to take advantage of BB10/04 so as to limit its VAT liability to the commission it charged. However, HMRC told the group that it could see no difference between the supplies made by ELS and those made by PNL to the colleges it was now contracted with. It therefore refused PNL the relief claimed under BB10/04.

Following the CJEU's decision in *Stichting Regionaal Opleidingen Centrum* (Case C-434/05), HMRC informed PNL that it accepted that the company was making supplies of staff and was entitled to take advantage of BB10/04. PNL wrote to HMRC claiming that there were no differences between the supplies made by PNL and those made by ELS; accordingly, ELS should benefit from BB10/04 to the same extent as PNL. HMRC's position was, however, that the choice to be taxed as an agent required to be made no later than the date of the relevant supply and could not be made with retrospective effect.

ELS sought permission to apply for judicial review of HMRC's decision on two grounds: HMRC was wrong about BB10/04 not being capable of being applied retrospectively; and, even if the choice to be taxed as an agent had to be made by the date of the relevant supply, that had in fact occurred in this case as part of the arrangements made in 2006/07 for the transfer of the ELS colleges to PNL.

Decision:

In relation to the first ground, the Court of Appeal found that nothing in the language of the concession indicated that the necessary choice was capable of being made with retrospective effect after the date of the relevant supply. Furthermore, BB10/04 was a decision by HMRC not to collect tax that became statutorily due; it should therefore not be given too great a scope. The Court of Appeal also dismissed the second ground of appeal. ELS had not made a choice to be treated as providing supplies of staff as an agent at the relevant time.

Comments - If a bureau acts as principal in the supply of its own personnel to the client, then VAT is charged on the whole sum payable to the bureau for the supply of services, which will include the cost of the salary payable to the personnel involved. However, if the bureau acts only as an agent in finding employment or an employee for its client, VAT is charged only on the commission payable to the bureau for the service it provides. Proceedings for judicial review are heard in the High Court, not before a tribunal, so judicial review can incur significant costs, which deters some applications for judicial review, unless the disputed VAT is significant.

The Queen on the application of ELS Group v HMRC EWCA

Repayment claim by a member of a VAT group

Summary -The Court of Session ruled that entitlement to reclaim overpaid VAT must properly be regarded as belonging to the representative member of the VAT group to which the company generating the overpayment belongs. This is so even if the right is assigned to the group member which generated the overpayment upon it leaving the group.

Taylor Clark was the representative member of a VAT group, which included Carlton Clubs, a company operating gaming machines and mechanised cash bingo. Following the CJEU's decision in *Finanzamt Gladback v Linneweber* (Case C-453/02) that income from gaming machines was not subject to VAT, Carlton Clubs had submitted four claims for repayment of VAT.

The issue was whether the VAT group could rely on the claims for repayment of VAT submitted by Carlton Clubs in November 2007 and January 2009, prior to the expiry of the transitional period for *Fleming* claims on 31 March 2009, as the claims should properly have been made by Taylor Clark.

Decision:

The Court of Session observed that, during the relevant period, Carlton Club had no existence for VAT purposes; Taylor Clark had carried on the trade and made the relevant input tax payments. Carlton Club's claim letters should therefore be treated as written on behalf of Taylor Clark. The court added that the fact that the claims extended to a period when Carlton Clubs had not joined the group (and had not been incorporated) was immaterial; as the VAT group existed at the relevant time, the claim had been properly made on behalf of the group.

Comments - The latest decision in this long running dispute, contrary to the findings of the First-tier and Upper Tribunals, was that the representative member of a VAT group is the person responsible for paying tax and for reclaiming tax, even if the payment or claim is generated by a different group company and even if that company is not a member of the group at the time of the claim. It is unclear whether HMRC will seek leave to appeal the decision, but in view of their comments in court that a judgment in favour of the appellant would fail to recognise the limitations of the 'single taxable person' concept and would cause them significant practical problems in dealing with such claims, it may be that we have not seen the end of the litigation in this case.

Taylor Clark Leisure v HMRC [2016] CSIH 54

Is the supply of prostheses part of a composite supply of medical care?

Summary - The UT found that the supply of prostheses was an element of an exempt composite supply of medical care.

General Healthcare supplied patients with artificial hips and pacemakers, and other prostheses. Supplies of prostheses were zero rated, whereas supplies of medical care in a hospital were exempt. The issue was the recovery of input tax incurred in relation to the supply of those prostheses.

General Healthcare contended that it made separate zero rated supplies of prostheses so that the input tax was recoverable HMRC, however, considered that the company made composite supplies of medical care, which were exempt and of which the supply of prostheses was merely a component element, so that the input tax was not recoverable.

Neither party contended that the supply of prostheses was ancillary to the supply of medical care by General Healthcare. The question was therefore whether the supply of the prostheses and other services and goods to the typical patient were 'so closely linked that they formed, objectively, a single, indivisible economic supply which it would be artificial to split' (*Levob* (Case C-41/04)).

Decision:

The UT held that the supply of the medical care and the prostheses by General Healthcare were inseparable and indispensable, because each was 'necessary for the other and meaningless without the other'.

Comments - Much litigation is generated by the application of the distinction between a composite supply and several distinct and independent supplies. The decision of the UT in this case seems to have been in great part influenced by the fact that the patient could not chose to receive the medical care without the prosthesis or vice versa.

General Healthcare Group v HMRC [2016] UKUT 315

Input tax on legal fees for the defence of a company director

Summary - The FTT allowed the appeal against HMRC's rejection of a claim to recover VAT charged on legal services relating to the defence of civil proceedings brought against a director.

Praesto had paid legal fees in relation to civil proceedings brought against Mr Ranson, its director and founder, by its former employer, CSP, with which it was in competition. The issue was whether Praesto was entitled to credit for input tax on VAT charged by Sintons, the law firm conducting the litigation.

Decision:

The FTT found that both Mr Ranson and Praesto had been clients of Sintons; the input tax had been incurred in relation to legal services supplied to Praesto. The fact that Praesto was not a party in the trial on liability did not affect that conclusion. Praesto had made the profits from any breach of duty by Mr Ranson and Praesto's profits would have to be accounted for, either by Mr Ranson or by Praesto itself, if CSP's claim was successful.

Praesto therefore had a direct interest in CSP's claim being dismissed, so that the link between the supplies and Praesto's taxable activities was sufficiently direct and immediate to entitle it to the input tax credit; the supplies had been made for the purpose of its business.

Comments - The outcome of this type of case depends critically on the facts. No doubt, if CSP had been successful in establishing a breach of fiduciary duty by Mr Ranson, then it would have sought to add Praesto as a party for the purposes of an account of profits.

The solicitors told Mr Ranson that the invoices should be addressed to him, rather than Praesto, so as to match the title of the proceedings. Perhaps there was another reason, e.g. the recovery of costs could be more straightforward if the invoices were addressed only to a party in the proceedings. The FTT did not consider that the fact that the invoices were addressed to Mr Ranson meant that the services were not also being provided to Praesto. For some reason, CSP chose not to name Praesto as a defendant. HMRC did not argue that the input tax should be apportioned.

Praesto Consulting v HMRC TC5245

Input tax on advertisement on a motor racing vehicle

Summary - In relation to arrangements in respect of which the director of the taxpayer's accountant had already been found guilty of fraud, the First-tier Tribunal held that advertising costs paid pursuant to an agreement that some of the costs would be rebated to the shareholder of the taxpayer did not qualify for a corporation tax deduction and that, for VAT purposes, input tax was not recoverable. There was insufficient evidence to conclude that a tax charge arose in respect of a loan to a participator in a close company under s455 CTA 2010.

In the January 2011 VAT period, Nick Jones Racing Ltd (NJR) invoiced the taxpayer for £25,000 plus VAT for advertising its name on the sill of a racing car support vehicle owned by NJR. The taxpayer claimed the input tax as an advertising cost. It also claimed the cost as a corporation tax deduction for the year ended 31 October 2010. The racing car company was owned by the son of the taxpayer's accountant, MJ, director of J & R Business Services.

HMRC disallowed the input tax claim on the basis that the expense was not for the 'purpose' of the company's business (s24(1) VATA 1994).

Decision:

The First-tier Tribunal learned that, under the advertising arrangement, the taxpayer issued two cheques to NJR: one for £20,000, which was never cashed, and one for £10,000, which was cashed. HMRC disallowed £20,000 of the sum claimed on the basis that there was no consideration and so no supply. It disallowed the remaining £10,000 on the ground that it exceeded the true value of the advertising.

The tribunal said there was no reason 'in principle' why input tax on advertising costs could not be treated as a business expense. However, the taxpayer had to show that the payment should be treated as one made for a supply in the course of its business. In this case, the taxpayer was unable 'to explain the value which was being obtained by the business for advertising in this way'.

Further, the taxpayer knew the £20,000 would not have to be paid, so the starting point for the value of the advertising was £10,000. But the tribunal agreed with HMRC that a company would be unlikely to spend such a large sum for advertising with so little benefit.

Finally, the tribunal disallowed the expense for corporation tax purposes on the basis that the main reason for the payment was to participate in a tax planning scheme.

Comments - Neil Warren, independent VAT consultant, said: 'Most VAT appeals about racing cars relate to situations where the car owner and business are connected, such as a 100% shareholder in a limited company claiming input tax on the expenses of a racing car he owns privately in return for an advertisement on the car. The advertising benefit is usually limited, giving HMRC an easy opportunity to disallow input tax claims under s 24. The *DTL* case was based on an avoidance arrangement between the director and his accountant that deserved to be defeated.'

DTL Supplies Ltd v HMRC TC5097

Deliberate or careless error? (Lecture B969 – 14.59 minutes)

Background

Deliberate or careless? Why is this question so important in the world of tax? The answer is because if HMRC decide that a business has made a 'deliberate error' on a past VAT return, resulting in an underpayment of VAT, then the error could be subject to a penalty of at least 35% of the tax in question if discovered by an officer (prompted disclosure). The key phrase for the amount of tax subject to a penalty is the 'potential lost revenue' (FA2007, Sch 24, para 8). However, if the error is deemed to be as a result of 'careless behaviour' by the business owner, the penalty can be reduced to nil if the error was 'unprompted' ie if the taxpayer revealed it to HMRC (perhaps by submitting an error correction form VAT1614A) rather than it being discovered by an officer on a compliance visit. And even if the officer found the error, where a minimum 15% penalty applies, the legislation gives power for the penalty to be suspended if the error was careless (with behavioural conditions forming part of the terms of the suspension) but this is not an option with a deliberate error.

The other key point is that if HMRC discover historic underpayments of VAT that they can show (on the balance of probabilities) were caused by the 'deliberate' actions of the business owner, then the legislation gives them the power to assess tax going back twenty years. In the case of non-deliberate errors (careless or human errors) their powers are capped at a four-year window.

What is a 'deliberate' action?

The challenge is for HMRC to consider all of the facts and make a decision based on the 'balance of probabilities' (the civil standard). In reality, the onus of proof is on HMRC to prove 'deliberate' behaviour but on the taxpayer to prove he was not 'careless' if the latter scenario is relevant. Here is a thought provoking question: if a VAT error is deemed by HMRC to be 'deliberate' – does this infer that the taxpayer must also have been 'dishonest'?

To help with the last question, here is the key definition from HMRC's guidance note CH81150:

"A deliberate but not concealed inaccuracy occurs when a person gives HMRC a document that they know contains an inaccuracy. It is not necessary to demonstrate that the person knew what the accurate figure was, only that they knew that the figure they put on the document was not accurate."

With regard to VAT, the guidance note gives the following example of a 'deliberate error'

> "giving a VAT return to HMRC that includes a figure of net VAT due that is too low because the person does not have the cash at that time to pay the full amount, and later telling HMRC the true figure when they have the funds to pay"

So in reality, when we think of deliberate behaviour, dishonesty is part of the outcome.

Case defeat for HMRC - Auxilium Project Management Ltd (TC5024)

It is fair to say that clients and business owners do the silliest things when it comes to tax. And the weak link in the HMRC approach is that officers sometimes under-estimate how silly these actions can be and incorrectly assume that dishonesty is on the radar. The APM case highlights this point perfectly.

The sole director and shareholder of APM was Gillian Edgar, who was also involved with an associated company called C&D Consultants (Southern) Ltd (referred to as C&D for the remainder of this briefing). Now here is the twist to the tale: APM raised a sales invoice to C&D in August 2014 for £236,362 plus £47,272.40 VAT, which the latter company claimed as input tax on its September 2014 VAT return. It paid APM regular instalments of £20,000 between 4 August and 26 August 2014 to settle the net amount, but it did not pay the VAT element until it received a repayment from HMRC for its September 2014 return, a net repayment claim of £49,470. But because C&D had not paid the VAT, Ms Edgar wearing her APM hat did not declare output tax of on the company's September VAT return. She should have declared output tax of £39,393 because she was on the cash accounting scheme so the gross receipts of £236,362 received from C&D should have been treated as VAT inclusive. Can you see the logic as far as Ms Edgar is concerned ie she should not declare the output tax to HMRC because HMRC has not repaid the input tax to C&D? But equally, can you see the logic of HMRC's visiting officer Mr Uren in clearly seeing that Ms Edgar has submitted two VAT returns where output tax was missed off one return but input tax claimed on the same transaction on the other one? Hence his conclusion that the £39,393 of output tax was subject to a 20% penalty (the minimum rate for an unprompted disclosure for a deliberate error not concealed). As a further twist, the return in question was completed by the company's accountants Vernon Associates, who took responsibility for the mistake.

The court agreed that Ms Edgar had not made a deliberate error. She had made a careless error but because this was deemed by HMRC to be an 'unprompted' disclosure, it was reduced to nil. Box 1 gives some important comments from the case report.

Box 1 – extracts from APM case report

Para 63. - In our view, a deliberate inaccuracy occurs when a taxpayer knowingly provides HMRC with a document that contains an error with the intention that HMRC should rely upon it as an accurate document. This is a subjective test. The question is not whether a reasonable taxpayer might have made the same error or even whether this taxpayer failed to take all reasonable steps to ensure that the return was accurate. It is a question of the knowledge and intention of the particular taxpayer at the time.

Para 65 - We found Ms Edgar to be an honest and credible witness. We accept her evidence. When she provided the information for the 09/14 return, she believed that she was providing accurate information. In particular, at that time, she thought that the correct approach in relation to the part payments of amounts under invoice 005 was to attribute those payments first to the non-VAT elements and then to treat the VAT element as paid as and when C&D recovered the input VAT from HMRC and was able to make the final payment to APM. APM would then be in a position to account for the VAT to HMRC.

Gryson Air Conditioning Equipment Ltd (TC4963)

The business had a compliance visit in 2014, which resulted in an assessment for £214,289, mainly relevant to output tax errors with calculations being prepared from manual records by various bookkeepers, rather than by using the company's Sage system, which appeared to be more accurate. Many sales invoices were included in the Sage system but excluded from the manual records. The extent of the errors in some periods was considerable eg £200,000 of sales were excluded in the March 2012 quarter, which represented nearly half of total sales for the period. The court supported the 42.5% penalty issued by HMRC:

"Although the directors claim that they only looked at the net amount of VAT payable when they reviewed the VAT summaries, we do not think that they could have failed to spot such significant errors."

Group One (Arshad Mehmood) (TC4986)

The taxpayer was assessed for input tax errors and a 70% 'deliberate error not concealed' penalty on the basis that he had claimed input tax but had no records to support these claims or any apparent business activity. For the periods in question, the VAT returns showed total inputs of £195,469 and no outputs. When he had first applied to be VAT registered, the taxpayer stated that his business activity was to import and sell various goods, including 'basmati rice, working gloves, kitchen towel and small leather items.' But the tribunal described the taxpayer's claim that a business existed as being "insufficiently persuasive" and agreed with HMRC that both the assessment and 'deliberate behaviour' penalties were correct (apart from a small reduction from 70% to 60% to reflect a degree of co-operation given to HMRC by the taxpayer).

Contributed by Neil Warren

Road fuel expenses – Tribunal defeat for HMRC (Lecture B970 – 12.43 minutes)

Background

The rules about VAT and road fuel have been with us for a long time and have always been well understood in most cases. So it was surprising that HMRC lost the First-tier Tribunal case of *Broadsteady Ltd (TC4886)*, so it is worth considering the facts of the hearing.

Road fuel scale charges

The law on road fuel and VAT is explained in s56, VATA1994. The basic outcome of s56 is that a business can claim input tax on all road fuel purchases it makes but must account for output tax on the fuel supplied to employees for their private use. Output tax is based on scale charges explained in s57 of the same Act, the charges being based on CO2 emissions of the vehicle in question.

So what happened in the Broadsteady case?

To set the scene, the issue was all about the company cars used by two sales reps employed by the company, who had the job of travelling around the country generating orders and keeping customers happy. It is not particularly relevant but the company traded as a wholesaler of alcoholic and soft drinks. To add a twist to the tale, the period of the assessment which was the subject of appeal covered VAT periods March 2010 to December 2012 but from April 2012 the two employees became home rather than office based workers. This trend towards more home working is very common in the modern technology world and another reason why this subject is very important.

Here are the relevant facts:

- **Until April 2012** - the employees travelled to the company's office each working day in their own vehicles and then travelled to see customers in two company cars, which were BMW1 series vehicles. The company cars were returned to the office at the end of the evening and the reps returned home in their own vehicles. A couple of times each year, the reps took the cars home because they had an early start the following morning and it made sense to start the journey from home.

- **After April 2012** – the reps became home based workers due to technology improvements. The vehicles were allocated to them personally to the exclusion of other employees and kept overnight at their homes. However, private use of the vehicles was prohibited by company policy.

The taxpayer's view was that input tax on road fuel expenses could be fully reclaimed without any scale charge payment. HMRC disagreed and raised an assessment for £1,386 for the periods in question ie concluding that output tax was due for both the pre and post April 2012 arrangements.

The law

As an opening comment, s56(1)(a) confirms that the private motoring rules apply to an employee for both "his own vehicle or a vehicle allocated to him" – the latter phrase meaning a 'company car' in simple speak. Sections (b) and (c) extend the rules to business owners' vehicles in the case of sole traders and partnerships. The legislation confirms that "an individual's own vehicle shall be construed as including any vehicle of which for the time being he has the use" (eg a friend's car that he has borrowed).

The point about all input tax being reclaimable is confirmed by s56(5), even though some of the fuel purchased by the business will be used for private purposes. And 56(5) confirms the need for output tax to be declared on the fuel used for private purposes based on the scale charge system.

Now here is the crux of the case: the Broadsteady cars were company vehicles, so the key issue before April 2012 was whether the cars were 'allocated' to the two employees. There is no dispute about the allocation after April 2012 when they kept them at their homes on a regular basis. The definition of 'allocated' is helpfully explained in 56(9) – see Box 1.

Box 1 - When is a car 'allocated' to an employee? (s56(9), VATA1994).

In any prescribed accounting period a vehicle shall not be regarded as allocated to an individual by reason of his employment if—

(a) in that period it was made available to, and actually used by, more than one of the employees of one or more employers and, in the case of each of them, it was made available to him by reason of his employment but was not in that period ordinarily used by any one of them to the exclusion of the others; and

(b) in the case of each of the employees, any private use of the vehicle made by him in that period was merely incidental to his other use of it in that period; and

(c) it was in that period not normally kept overnight on or in the vicinity of any residential premises where any of the employees was residing, except while being kept overnight on premises occupied by the person making the vehicle available to them.

It is always important to check whether the word 'and' or 'or' appears in either VAT legislation or HMRC guidance. In this situation, the word is 'and' – so all three conditions of 56(9) need to be met for a vehicle to be deemed as not 'allocated' to an employee. If all three conditions are met, then no scale charge payment is needed.

So how did HMRC justify an assessment in the pre-April 2012 periods, when the cars were kept at the company premises and only used by the reps for business journeys to customers, and other employees had use of the cars as well? In other words, the cars appeared to meet the definition of a 'pool car' which escapes the scale charge system.

To quote from para 33 of the report:

"Mr Haley submitted that in the period prior to April 2012 on those occasions when the vehicles were taken home in the evening or driven from home in the morning there was private mileage." (Note – Mr Haley represented HMRC in the court).

However, the tribunal dismissed that argument in the same paragraph with a strict application of para 56(9)(b):

"It is certainly possible that some of that mileage was from home to office and therefore capable of being treated as private mileage. However we have found that such occasions were rare and arose only if there had been a late appointment the night before. We are satisfied that any such private mileage by each of the Sales Reps was merely incidental to their other use of the vehicles."

Bad news for HMRC so far but they also lost the argument with the post April 2012 periods when the two employees became home based. There can be no dispute that they have failed s59(c) from Box 1 because they keep their vehicles at home. In other words, the vehicles have lost their status as 'pool cars'. But the tribunal concluded that there was no private use of the vehicles in question and therefore there was no need to consider the pool car rules because s56(1) says that the scale charge system only applies when fuel is "provided by the taxable person to an individual for private use". HMRC claimed that the employees were still office rather than home based after April 2012 and therefore all trips to the office were 'private' trips but this argument was rejected by the tribunal: "We are satisfied that in the period after April 2012 the Sales Reps were home based employees and that any travel between home and the Appellant's office was not private use." (para 33)

Conclusion and other tips

As a thought provoking question, is it possible for company car used by an employee to have 'no' private use? My personal view is that it is possible to have 'incidental' use but not 'no private use'. Think of the occasional de tour for shopping and other personal trips.

Here are three other tips about motor expenses:

1. If detailed mileage records are kept in relation to a vehicle, then input tax on road fuel purchases can be apportioned – this means that no scale charge payment is needed.
2. In relation to car leasing expenses, don't forget that 50% input tax can be claimed, even though the business use percentage for a vehicle might be lower (or higher) than this percentage.
3. If an employee is charged for his private vehicle use on a leased car (eg through salary deduction), then no output tax is payable on the payment because the 50% input tax block has already dealt with the VAT issues.

Contributed by Neil Warren