

# Tolley® CPD

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## Personal tax

### Company cars – latest advisory fuel rates (Lecture P1126 – 15.11 minutes)

HMRC has published revised advisory fuel rates for company cars, applying from 1 March 2019. The previous rates can be used for up to one month from the date the new rates apply.

Engine size	Petrol - per mile	LPG - per mile
1400cc or less	11 pence	7 pence
1401cc to 2000cc	14 pence	8 pence
Over 2000cc	21 pence	13 pence

Engine size	Diesel
1600cc or less	10 pence
1601cc to 2000cc	11 pence
Over 2000cc	13 pence

The rates are to be used only where employers either reimburse employees for business travel in their company cars, or require employees to repay the cost of fuel used for private travel.

Hybrid cars are treated as either petrol or diesel cars for this purpose.

The advisory electricity rate for fully electric cars is 4 pence per mile.

*[www.gov.uk/government/publications/advisory-fuel-rates](http://www.gov.uk/government/publications/advisory-fuel-rates)*

### Leased cars and fuel card payments (Lecture P1126 – 15.11 minutes)

*Summary – Leased cars and fuel card payments for private fuel provided to directors were not benefits in kind as they were effectively paid for in full via debits to the directors' loan accounts.*

Paul Harrison and Lee Solway were both directors and each owned 50% of the shares in Harrison Solway Logistics Ltd, a haulage company.

In May 2013 HMRC looked into the company's employer records that included details of company cars. In July 2013 HMRC were told that there were no company cars, but that the directors had leased cars the costs of which were paid by direct debit and taken to their loan accounts. The directors also had a fuel card, which they used when they filled their private cars, and the cost of these cards was also taken to their loan accounts.

The directors appealed against HMRC's decision that for the tax years 2010/11 to 2013/14:

- cars leased by the directors were company cars under s.114(1), ITEPA 2003 as they were made available to the directors by reason of their employment and without any transfer of the property in them and they were available for private use; there was no transfer of proprietary interest in the cars as it was Harrison Solway Logistics Ltd which entered into the leasing agreements and the cars always remained the property of the lessor;
- company fuel cards given to the directors were taxable as benefits under s.150 ITEPA 2003 as the directors did not reimburse the company for their private fuel.

Harrison Solway Logistics Ltd appealed against HMRC's decision that Class 1A charges were due on the car and fuel benefits as well as penalties for the failure to deliver P11Ds for benefits provided to the directors.

In Harrison Solway Logistics Ltd's view:

- there was an oral and implied arrangement between the company and directors in respect of the vehicles leased by the company, under which property had passed to the directors so that s. 114(1)(a) ITEPA 2003 was not satisfied. All costs in respect of the vehicles had been borne by the directors through their directors' loan accounts, so there had been no provision of a car benefit;
- all fuel costs were met by use of directors' loan accounts;
- The directors received no overall financial benefit having met the full cost of the vehicles on commercially available terms. Debits on an overdrawn loan account represent payments as the loan account represents an enforceable debt and was not different to any other loan.

### *Decision*

The First Tier Tribunal said they could see no reason for not taking the directors' loan accounts debits into account as these were the amounts of the hire purchase and rental payments made by Harrison Solway Logistics Ltd to the leasing companies. The directors were effectively leasing the cars giving them the right to use them for business or private use. There was no benefit and so s.114 ITEPA 2003 did not apply. The same applied to the fuel cards.

As there was nothing to be charged to income tax in relation to cars and fuel, no income tax and interest was due. Had the cars and fuel been the only 'benefit' to consider no Class 1A or penalties for failing to file a P11D(b) in time would have arisen either. However, there were other benefits accruing to the directors from BUPA subscriptions etc, which had not been reported.

In summary, the income tax appeals were allowed with the Class 1A NICs appeals allowed in part.

*Mr Paul Harrison, Mr Lee Solway & Harrison Solway Logistics Ltd V HMRC (TC06956)*

## **Insurance premium payments (Lecture P1126 – 15.11 minutes)**

*Summary – The payment of insurance premiums by the company did not represent earnings from the employment of its director.*

William Mitchell was the sole director and shareholder of Macleod and Mitchell Contractors Limited.

The company paid insurance premiums on several insurance policies where, until 2013, both the company and William Mitchell understood that the company was the policyholder, Mr Mitchell was the insured person and that the company would be the party that would benefit from any insurance proceeds. Having discovered that this was not the case, and that an error had been made, Mr Mitchell assigned the policies to Macleod and Mitchell Contractors Limited in 2014.

In the period up to the assignment, HMRC assessed Mr Mitchell to income tax in respect of the premiums paid and the company was assessed to pay primary and secondary class 1 national insurance contributions.

Macleod and Mitchell Contractors Limited and Mr Mitchell appealed to the First Tier Tribunal who accepted that a mistake had been made. However, as Mr Mitchell was the policyholder, the Tribunal held that the premium payments had relieved him of pecuniary liabilities to the insurers, so that the payments were earnings under s62 ITEPA 2003.

### *Decision*

The Upper Tribunal considered whether the payment of the premiums by the company conferred a profit or benefit upon Mr Mitchell that derived from his employment and so was taxable as general earnings.

Referring to the test in *Tyrer v Smart*, they said that the test ‘is whether the benefit represents a reward or return for the employee’s services, whether past, current or future, or whether it was bestowed on him for some other reason...’.

In their opinion, the Upper Tribunal found that the First-tier Tribunal had erred in law and had failed to focus correctly on the critical questions - whether there was any real benefit to Mr Mitchell from the payment of the premiums; and if there was, whether it arose from his employment.

They concluded that “the premium payments were very clearly not earnings from Mr Mitchell’s office or employment.....they were bestowed upon him for some other reason”. The premiums were paid to benefit Macleod and Mitchell Contractors Limited, not Mr Mitchell. They were made on the erroneous understanding that Macleod and Mitchell Contractors Limited was the policyholder and that it would be the beneficiary of any policy proceeds.

The same analysis applied in relation to the national insurance contributions.

*Macleod and Mitchell Contractors Limited William Mitchell v HMRC [2019] UKUT 0046 (TCC)*

## **Pension contributions paid for employee (Lecture P1126 – 15.11 minutes)**

*Summary - The taxpayer was not careless in claiming relief for pension contributions on his tax return as these were his contributions paid by his employer on his behalf.*

Adrian Omar had been given advice by pension providers that contributions he made to his pension schemes would be tax deductible. He subsequently paid contributions into his pension.

Mr Omar's income consisted of a basic salary plus variable bonuses. The bonuses between 2008 and 2014 varied between £60,000 and £20,000. His (somewhat hazy) recollection was of making lump sum contributions of some £8,000 in 2011/12 and £5,000 in 2010/11 and of asking his employer to pay part of his bonus in making these payments.

Mr Omar's payslips showed gross income followed by deductions for national insurance and tax to give net income. From that, pension payments were deducted to give the net sum that was paid to him. To obtain the sum that he entered in his tax return for pension payments he summed the amount of the pension payments shown on those payslips.

However, the pension fund's summary of the transactions included a payment of £8,018 described as "... employer's single contribution". Mr Omar did not use this summary to complete his tax returns but HMRC used this as evidence that Mr Omar had claimed too much relief on pension contributions.

Section 188 ITEPA provides that an individual who is an active member of a registered pension scheme is entitled to relief in respect of pension contributions paid during the year, but that such contributions do not include -

"(3)... (b) any contributions paid by an employer of the individual ..."

HMRC argued that Mr Omar had included in the figure in his return for pension contributions amounts contributed by his employer. This was evidenced in 2011/12 by the description in the pension fund statement of £8,018 as being his employer's single contribution. The payments made by his employer were not deductible. It was careless to have put them in the return. HMRC issued assessments on the basis that Mr Omar had claimed excessive deductions.

### *Decision*

The First Tier Tribunal disagreed with HMRC's view that Mr Omar had been careless. He had acted on the advice of experts and there was no additional requirement to look at HMRC's material.

Mr Omar's evidence was that the £8,108 amount was shown on his payslip as a deduction from his after-tax income. If that was right, then it was correct to treat it as a sum paid by him and not by his employer.

On balance the Tribunal did not find that the statement from the pension fund was adequate to convince them that it was more likely than not that the £8,018 payment had not been made on behalf of Mr Omar rather than “by” the company: given that regular payments were made by deduction from Mr Omar’s net income and paid through the company, it seemed quite possible that the pension fund had wrongly assumed that a large payment coming from the company was a payment by it rather than a payment on behalf of Mr Omar.

The Tribunal found that it was not shown by HMRC that the return had been incorrectly completed, and as a result that it was not shown that Mr Omar had been careless in its completion.

*Adrian Omar v HMRC (TC06962)*

## **Mis-selling redress payment**

*Summary – Although not blameless, given the difficult times and circumstances, the Tribunal reduced the penalty that was due on failing to declare the compensation received to zero.*

Anthony and Elizabeth Lovell, a married couple, were in partnership, running a nursing home.

Many years ago they took out an interest-rate hedging product with Barclays Bank in respect of a loan used to buy a nursing home. The hedging product premiums were correctly deducted in their tax returns as business revenue expenses.

In December 2013, following a review by the Financial Conduct Authority, the couple received a redress payment from Barclays Bank concerning the mis-selling of this product but the couple did not include the amount on their tax returns.

HMRC issued discovery assessments and imposed penalties.

The taxpayers appealed. They were in dispute with the bank about the compensation and believed the tax would be paid when that was resolved. They later accepted the assessments but said the penalties should be cancelled because they had a reasonable excuse. They claimed that they had followed advice received from Rational Tax Ltd, experts in the field, that tax should not be payable on the compensation. They were similarly advised by another firm, Bully-Banks, who assisted them to make the claim for the redress payment, and by Pragmaticum, another firm assisting them with their claim. Anthony Lovell claimed that he had attended conferences at which this was stated. Although he did not receive individualised advice on his own specific circumstances, the advice that the redress payments were not taxable was given to hundreds of people, who were told that this advice applied to all of them.

### **Decision**

The First Tier Tribunal said several factors made this case 'unusual' and 'unlike a typical careless failure to omit from a tax return a receipt that should have been included as income'.

The Tribunal concluded that:

- the couple were going through an extremely difficult financial time after the mis-selling and having to deal with complex issues that they did not understand;
- HMRC had published guidance in July 2014 on the appropriate tax treatment of such redress payments and that the taxpayers were aware of that guidance when they submitted their 2013/14 returns.

This was an unusual one-off receipt, with a complicated background. It was received at a time when the taxpayers were overwhelmed in dealing with various matters, some of which were financial consequences attributable to the product that they had been mis-sold.

The Tribunal stated that the taxpayers were not blameless. They might have disclosed the payment and explained the circumstances in the white space in their tax returns. However, having regard to the circumstances as a whole, including the fact that they accepted at an early stage that the redress payment was liable to tax even though this was a matter still subject to litigation in other cases, the Tribunal decided that it was appropriate to reduce the penalty to zero.

The taxpayers' appeal was allowed.

*Anthony Lovell and Elizabeth Lovell v HMRC (TC06938)*

### **Petrol services – Directors or consultants Lecture (P1126 – 15.11 minutes)**

*Summary – The services that were provided were what directors of a close company would be expected to perform and so were taxable as remuneration with tax and NICs collectable through PAYE.*

Petrol Services Limited had two directors, Mr Odedra and Mr Badiani, who together with their wives had been 25% shareholders since July 2007.

The company ran petrol stations but had no employees. The company operated by letting out the shops and car wash at the petrol stations to tenants who paid rent in return but also collected payment for the fuel on behalf of the company.

The directors were not paid any remuneration. Under separate consultancy agreements the directors were required to work up to 15 hours a week in exchange for a fixed amount each month. The directors usually worked together buying petrol, setting prices, collecting takings/rent, inspecting the premises, insuring the business, arranging repairs, and conducting occasional rent reviews/applications which usually amounted to between 20-40 hours of work each week.

HMRC argued that the directors had a contract of services and so should have been liable to income tax and NICs collected by Petrol Service Limited under PAYE. HMRC supplied third party notices showing that the directors had contracted with the company's suppliers in their capacity as officers of the company and not as contractors.

The two directors claimed they had a contract for services that was separate to their directorships and taxable as the income relating to their respective businesses.

### *Decision*

The Tribunal said that it is possible for an individual to have his own independent business while also having the office of director of a company, but in their experience this does not normally occur where the individual is a competitor of, or in the same line of business as, the company as appears to have been the case here. The services that were provided were what directors of a close company would be expected to perform. The Consultants provided no additional services. The payments were effectively remuneration that should have been processed through PAYE. It did not matter that the remuneration was paid to the directors' businesses; it was still taxable on them.

The appeal was dismissed

*Petrol Services Limited v HMRC (TC06907)*

### **Off-payroll working rules from April 2020 (Lecture P1127 – 17.56 minutes)**

The off-payroll rules (IR35) are designed to ensure that individuals who work like employees but through an intermediary, such as a personal service company (PSC), pay income tax and National Insurance Contributions (NICs) inline with the amount that an employee would pay if they were doing the same role.

The government believes that the cost of non-compliance with the off-payroll working rules in the private sector is growing and will reach £1.3 billion a year by 2023/24. Since April 2017 we have seen public authorities accounting for and paying income tax and NICs under PAYE to HMRC, on behalf of such workers. With PAYE receipts and independent research on off-payroll suggesting that this public sector reform has been effective in increasing compliance without impacting labour market flexibility, from 6 April 2020, the government now wants to extend the rules to the private sector. On 5th March 2019, HMRC published their consultation on the implementation of this reform, which runs until 28th May 2019.

#### *April 2020 reform*

The April 2020 reform will use the public sector off-payroll working rules as a basis to work from so clients and fee payers in both the public and private sector will be responsible for:

- determining employment status;
- deducting income tax and NICs as well as paying the employer NICs.

Any rule amendments that are made following this consultation will apply equally to the public and private sector.

#### *Included parties*

It is proposed that the new rules will apply to medium and large businesses in the private sector using the services of off-payroll workers but will exclude small businesses as defined by s382 CA 2006.

So a business that satisfies two or more of the following requirements:

Annual Turnover not more than £10.2m;

Balance sheet total not more than £5.1m;

Number of employees not more than 50.

For non-corporate entities where the balance sheet total may not be appropriate, two options are being considered:

1. Apply the reform to unincorporated entities with 50 or more employees and to entities with turnover exceeding £10.2 million; or
2. Apply the reform only to unincorporated entities that have both 50 or more employees and turnover in excess of £10.2 million.

#### *HMRC Example 1*

ABC Cash and Carry is a partnership specialising in the wholesale of goods to local businesses. The partnership employs 40 employees in various roles and in its accounting period ending 31 December 2019 it has a turnover of £8.7 million. ABC Cash and Carry has recently launched a website which allows their customers to place orders online. They engage an off-payroll worker through Agency Ltd to manage their website on their behalf.

It is now 6 April 2020 and the partnership must now decide whether or not the reform applies to them.

ABC Cash and Carry has fewer than 50 employees and less than £10.2 million in turnover. The partnership is considered small for the purposes of the reform under both options and does not have to apply the rules.

#### *Small private sector organisations*

Small private sector organisations will not be responsible for determining if the engagement is within scope of the off-payroll working rules. The off-payroll worker will be required to consider whether Chapter 8, Part 2 ITEPA 2003 applies to that engagement, as at present.

When an organisation becomes, or ceases to be small in an accounting period, for the purposes of the off-payroll working rules that change will apply from start of the tax year following the end of that accounting period.

#### *HMRC Example 3*

ABC Cash and Carry is a partnership specialising in the wholesale of goods to local businesses. The partnership employs 40 employees in various roles and it has a turnover of £8.7 million.

ABC Cash and Carry has recently launched a website which allows their customers to place orders online. They engage an off-payroll worker: Philip Johnson, of PJ Web Services Ltd through Agency Ltd to manage their website on their behalf.

It is now 6 April 2020, the partnership must now decide whether or not the reform applies to them. ABC Cash and Carry has fewer than 50 employees and less than £10.2 million in turnover. The partnership is considered small for the purposes of the reform and does not have to apply the rules.

As the reform does not apply to ABC Cash and Carry, it has not provided a determination to Agency Ltd or to the off-payroll worker Philip Johnson. All payments made by ABC Cash and Carry to Agency Ltd for Philip Johnson's services are for the full invoice amount and are not accompanied by a client status determination.

Agency Ltd are therefore not required to make any deductions for income tax and employee NICs, or pay employer NICs on any payments made to PJ Web Services Ltd for Philip Johnson's services.

When PJ Web Services Ltd is calculating its tax liabilities it will need to consider whether the engagement held by Philip Johnson with ABC Cash and Carry would have been one of employment were it not for the existence of Philip Johnson's company PJ Web Services Ltd.

If this is the case, then PJ Web Services Ltd would need to apply the reformed off-payroll working rules for engagements with small entities in the private sector, to be set out in Chapter 8, Part 2, ITEPA 2003.

#### *Additional points*

Anti-avoidance provisions will ensure that parties connected to, associated with, or controlled by the client cannot take advantage of the provisions to exclude small private sector clients from having to consider the status of their off-payroll workers.

#### *Responsibilities down the supply chain*

Under the public sector rules, clients must provide a status determination to the party they contract with by the time the contract starts or before the off-payroll worker starts work. If requested, the client must provide their reasons for the determination in writing within 31 days of the request.

If the off-payroll working rules apply:

- the fee-payer is required to deduct income tax and NICs from any invoice amounts and to pay it to HMRC.
- the off-payroll worker is required to inform a fee-payer of the nature of the structure they are working through as well as information to allow it to correctly account for Pay As You Earn (PAYE).

The government considers it necessary to legislate to ensure that the determination and the reasons for that determination are passed down to all parties within the labour supply chain, to ensure they comply with their obligations.

They are proposing that:

1. The client must provide the off-payroll worker as well as the party they contract with (e.g. an agency) the status determination for each engagement;
2. Status determination and reasons for that determination are passed down the contractual chain at, or before, the time they make the first corresponding payment;
3. Off-payroll worker and the fee payer have a right to ask for reasons for the determination directly from the client.

This proposal will ensure fee-payers who are further down the labour supply chain have the information they need to comply with the rules. The government wants to know more about typical labour supply chains and the role of any intermediary parties in the chain, in particular where more than one agency or party exists between the client and the worker's PSC. The government appreciates that, if the supply chains are long, a "short-circuit" approach may simplify the information flow, with the fee-payer receiving the determination directly from the client.

#### *Offshore PSC*

Where the organisation paying the worker's PSC is based offshore, the fee-payer responsibilities move up the supply chain to the next UK-based entity. The government is seeking views on how the engager may be in a position to identify this fee payer.

Where a potential fee payer has not received a determination, it would not be required to make any income tax and NICs deductions, or pay employer NICs, until such a time as it has received a determination.

#### *Non-compliance*

Chapter 10, Part 2 ITEPA 2003 provide for income tax and NICs to be transferred from one party to another where a client fails to provide a determination. Extending these existing provisions would provide an effective mechanism for preventing and addressing non-compliance with the rules following the April 2020 reform.

- Where HMRC does not receive the tax due, the liability will initially rest with the party that has failed to fulfil its obligations, until such a time that it did meet those obligations. This means that liability would move down the labour supply chain as each party fulfils its obligations. For example, if an agency in the chain failed to send on the determination that agency would be liable for any income tax and NICs due. Similarly, if a fee-payer, having received the determination failed to make deductions from any payments made to the worker's PSC then it would become liable.
- If HMRC were unable to collect the outstanding liability from that party, for example, because it ceased to exist, the government proposes that the liability should transfer back to the first party or agency in the chain.
- Where HMRC could not collect from the first party or agency it would ultimately seek payment from the client.

The advantages of this approach are that it would provide a clear incentive for all parties to comply with their obligations and to ensure a determination is passed fully down the chain. This approach would also encourage all parties to contract with reputable and compliant firms and ensure that appropriate due diligence is undertaken before the start.

#### *Status determination disagreement*

The government understands that in some circumstances an off-payroll worker or fee-payer may disagree with a client's status determination.

Where the fee-payer or off-payroll worker have not received the reasons for the status determination together with the status determination, the government thinks it is appropriate to provide the off-payroll worker and the fee-payer with the right to seek the reasons for the status determination directly from the client. This would be the first step in seeking to resolve status disagreements.

Additionally, it may be necessary for a process to be put in place to allow for determinations to be challenged. The current proposal is for clients to develop and implement their own processes to resolve disagreements based on a set of requirements to be set out in the legislation. They believe that public sector and medium/large-sized private sector organisations are likely to already have HR processes in place either in-house or sub-contracted to relevant service providers for managing workplace disputes. The government would expect the process to consider evidence put forward by the off-payroll worker and/or fee-payer, advising the party of the outcome of that consideration and the reasons for that outcome.

#### *Accounting for tax and NICs*

Under the proposals, where the rules apply, the process will work as it currently does for the public sector.

- The fee-payer is the deemed employer for income tax, NICs and Apprenticeship Levy purposes but will not be required to make deductions for student loan payments;
- The fee paid to the PSC is the off-payroll worker's employment income;
- The employment income will be the VAT exclusive amount paid to the worker's PSC.
- The off-payroll worker must provide their NI Number, tax code and identity details to enable the right tax to be deducted;
- On or before the fee-payer makes payment, the fee-payer must complete the RTI process and notify HMRC of the amount of the taxable earnings and the tax and NICs deducted.

The deemed employment relationship does not result in employment rights or statutory payments obligations for the deemed employer or fee-payer.

### *Employment Allowance*

All employer NICs paid as a result of deemed employment income are excluded liabilities for the purposes of the Employment Allowance. They would not be able to claim the Employment Allowance against secondary Class 1 NIC liabilities arising from the payment of deemed employment income.

### *5% allowance*

As with public sector engagements the worker's PSC will no longer be permitted to deduct a 5% allowance in relation to engagements with medium and large-sized clients.

### *Contracted out services*

The off-payroll working rules require a worker to personally perform, or be under an obligation to personally perform, services for the client.

Private sector organisations that contract-out services to a third party will not be required to apply the off-payroll rules, as for public sector bodies. In such cases, the third party would be required to consider whether the off-payroll working rules apply, and if they do, it will be responsible for deducting and paying the appropriate tax and NICs

### *Agency legislation*

Where an agency contracts directly with the worker as an employee and operates tax and NICs, or engages them on a self-employed basis but operates tax and NICs under agency rules, then the off-payroll working rules do not apply. (See Chapter 7, Part 2 ITEPA 2003).

### *Umbrella companies*

Where an umbrella company employs the worker directly as an employee and does not contract with the worker's PSC, the off-payroll working rules do not apply. If the worker's PSC receives payments for the off-payroll worker's service through their PSC then the off-payroll working rules will apply.

### *Off-payroll working rules taking precedence*

Where the conditions in the off-payroll working rules apply, these rules will take precedence over the managed service company rules in Chapter 9, Part 2 ITEPA 2003 and the rules in the construction industry scheme.

### *Check Employment Status for Tax (CEST) service*

The CEST service was launched in 2017 and the government believe that it is able to determine employment status in 85% of cases. An enhanced CEST service will be available before the reform is implemented in 2020 and HMRC will produce an education and support package to:

- give relevant information to those who will need to apply the off-payroll working rules, such as: HR directors, hiring managers, and off-payroll workers so they can act on the changes in time for April 2020;

- meet the needs of different users. For example clients will be pointed towards specific guidance on making the status decision, fee-payers to guidance on operating payroll, and off-payroll workers will have easy access to guidance specific to them, such as how to apply the existing rules when providing their services to small clients.

*Actions to take now*

The government recommends that those affected by the reform should start now to:

1. Review current engagements with intermediaries, including PSCs and agencies that supply labour to them;
2. Review current arrangements for the use of contingent labour, particularly within the organisation functions that are more likely to engage off-payroll workers;
3. Put in place comprehensive processes, across procurement, HR, tax and line management perspective, to ensure consistent decisions on employment status;
4. Review existing systems to see if they need to make any changes.

*<http://www.gov.uk/government/consultations/off-payroll-working-rules-from-april-2020>*

## Capital Taxes

### Avoiding CGT on shares (Lecture P1126 – 15.11 minutes)

*Summary – A scheme designed to avoid CGT on the disposal of shares failed under the Ramsey principle, as it should be viewed as a single composite transaction, namely the disposal of quoted shares at or about market value by the original trustees.*

Back in October 2017 we reported on the Upper Tribunal's decision in this case where trustees had disposed of listed shares using a tax avoidance scheme.

Scottish trustees held shares representing about 2% of AWG Plc that at the time had a combined market value of around £14.5m. If sold, CGT would be payable of around £3 or £4 million.

The scheme involved the setting up of trusts in Ireland, The Irish trustees granted put options entitling the Scottish trustees to sell the AWG shares at base cost plus indexation; this would realise cash totalling nearly £4.5m. The Scottish Trustees would not incur any CGT as under s144ZA TCGA 1992 as the disposal was through the exercise of an option the market value rule would be dis-applied. Having exercised the options, the shares were then sold by the Irish trustees to Merrill Lynch; this realised a total of just over £14m net for the Irish trusts with the trustees incurring an Irish CGT liability of around €54,000. Finally, the Irish Trustees retired and were replaced by the same persons who held the office of Scottish Trustees, the Irish Trusts were thereby repatriated to the UK.

Both the First Tier and Upper Tribunal held that, viewed realistically, the case involved a single composite transaction, namely the disposal by the Scottish trustees of the AWG shares to the market at or about market value. The intermediate steps had been artificially inserted for tax avoidance purposes. Accordingly, HMRC were correct to view the arrangements as a single disposal. CGT had not been avoided.

#### *Decision*

The Court of Appeal agreed with the First Tier and Upper Tribunal in finding that the overall scheme had been pre-ordained to produce a given result and those events did in fact take place.

They concluded that 'In the present case, where the asset comprised a shareholding in a quoted company, nothing of any significance needed to be done by [the disposal date], for a rapid sale in the market to be achieved.'

The Ramsay approach was in point and the Scottish Trustees should be regarded as having effected a "disposal" of the AWG shares to Merrill Lynch within the meaning of the TCGA. The scheme, which had been designed to avoid CGT on the disposal of the shares, failed.

The appeal was dismissed.

*Trustees of the Morrison 2002 Maintenance Trust + others v HMRC, CA [2019] EWCA Civ 93.*

## **Assets held in trust? (Lecture P1126 – 15.11 minutes)**

*Summary – The taxpayer held the funds in the bank accounts as trustee on bare trust for her parents-in-law and was not taxable on the income and gains arising.*

Lily Tang was an NHS midwife who was a basic rate taxpayer paying tax on her salary under PAYE.

However, she held over \$900,000 in bank accounts in London and then later in accounts in Asia. She was the legal owner of the funds; she had control over the monies and was entitled to give instructions to transfer them to another account and to make currency trades. She had transferred the funds back to her parents-in-law in 2017.

She argued that she was holding the money for her Hong Kong resident parents-in-law. As bare trustee, she believed that she had no personal tax liability in respect of these funds and so no need to complete a tax return.

By contrast, as there was no trust document, HMRC considered that the funds belonged to her and raised discovery assessments accordingly.

The issue was therefore whether a trust existed.

### *Decision*

The First Tier Tribunal understood that Lily Tang lived with her husband in a house bought for £73,000 with a mortgage and that she worked nightshifts to enable the couple to look after her children as childcare was expensive. This was inconsistent with her having access to \$900,000 at her disposal which she did not spend.

The Tribunal disagreed with HMRC and said that a trust does not need to be in writing and may be made orally. They referred to a statement prepared by BDO that detailed how the money had been transferred to Mrs Tang as legal owner only with her parents-in-law as the beneficial owners. The Tribunal concluded that, on balance of probabilities, Lily Tang did hold the funds as trustee on bare trust.

As neither the income nor gains belonged to her, she was not taxable on them and was not required to notify them to HMRC.

*Lily P Tang v HMRC (TC06965)*

## **SDLT on dilapidated bungalow Lecture (P1126 – 15.11 minutes)**

*Summary – The property was not suitable for use as a dwelling at the time of purchase and so higher SDLT rates did not apply.*

Mr Bewley had bought a bungalow that had not been occupied for a couple of years and was described in a survey as being in poor state of repair and requiring demolition due to asbestos. A planning application made it clear that the existing building was to be demolished and replaced with a new building.

At the date of completion HMRC sought to collect the higher rate of SDLT for additional residential properties under FA 2003, Sch 4ZA, Part 1) but the taxpayer disagreed and appealed.

### *Decision*

The Tribunal accepted that the dilapidation did not necessarily prevent it from being a dwelling but added that the test was whether the property was 'suitable to be used as a dwelling at the time of purchase', and not 'whether it was capable of becoming so used in the future'. The planning permission was therefore not relevant.

The First-tier Tribunal stated that 'No doubt a passing tramp or group of squatters could have lived in the bungalow as it was on the date of purchase but, referring to HMRC's own Guidance Note (16 March 2016) to be suitable to be used there was a need for 'facilities required for the day-to-day private domestic existence.' These facilities were not present on the completion date. Additionally, given the state of the building, with the presence of asbestos preventing any repairs or alterations, the Tribunal found that the bungalow was not suitable for use as a dwelling.

The higher rate, on purchases of additional residential properties, did not apply.

The appeal was allowed

*P N Bewley Ltd v HMRC (TC06951)*

## **SDLT developments (Lecture P1130 – 14.09 minutes)**

### *Relief for first-time buyers in cases of shared ownership*

SDLT is a tax on the purchase of land and buildings in England and Northern Ireland. It was devolved to Scotland in April 2015 and to Wales three years later. There are two main charging regimes within the SDLT code. These relate to:

1. transactions involving residential property; and
2. transactions involving commercial and mixed use property.

Purchasers are charged at a variety of different percentages of the consideration that they pay for their acquisition of a property interest.

The special relief for first-time buyers was introduced by S41 FA 2018 with effect from 22 November 2017. It applies where the purchaser is a first-time buyer acquiring a home. Relief is available where the consideration for that home is £500,000 or less. Where the relief is claimed, SDLT is charged at 0% on the first £300,000 of consideration and then at 5% on any excess (but only up to £500,000). First-time buyers paying more than £500,000 for their property do not qualify for any relief.

A first-time buyer is defined as an individual who has never owned an interest in a residential property in the UK (or elsewhere) and who intends to occupy that property as a main residence.

Qualifying shared ownership schemes are provided by local authorities and housing associations that help individuals to buy a property, which they might not otherwise be able to afford, by allowing them to purchase a share in the property and pay rent on the remainder.

Originally, first-time buyers were only eligible for the FA 2018 relief in connection with their participation in a shared ownership scheme if they made an election to pay SDLT on the full market value of the property. Understandably, this was not a popular requirement and so an amendment has now been tabled to extend the relief to purchases where the first-time buyer does not make a market value election on the initial transaction. This applies where the relevant shared ownership purchase is completed on or after 29 October 2018.

In addition, a change has been made to allow first-time buyers, who acquired a property via a shared ownership scheme before the relaxation set out above, to claim a repayment of their overpaid SDLT as though the new rules had been in place at the time of the introduction of the relief last year. This late repayment claim can be made up to 29 October 2019. It must be claimed in an SDLT return or, by amendment, where an SDLT return has already been filed.

#### *Higher rates of SDLT for additional dwellings*

Sch 4ZA FA 2003 was brought in by S128 FA 2016. It contains legislation to charge higher rates of SDLT when a company or discretionary trust acquires residential property and when individuals who already own residential property do so.

An exception to this rule occurs if someone with another residential property sells their present home and buys a new one. The additional 3% is not chargeable if the old home is sold before the new home is bought or if the old home is sold within three years after the purchase of the new home. In this latter case, the SDLT surcharge must initially be paid upfront but can then be claimed back when the sale of the old home goes through within the appropriate time-scale.

The time limit for submitting an amended SDLT return in this situation has always been the later of:

- (i) three months from the completion date for the sale of the old home; or
- (ii) 12 months from the return's filing date for the new home.

However, where the completion date for the sale of the old home falls on or after 29 October 2018, the three-month period referred to above becomes a 12-month period.

#### *Changes to periods for delivering SDLT returns and paying tax*

The Chancellor has announced that the time limit for filing an SDLT return and paying the tax due will be reduced from 30 days to 14 days. This applies to transactions for the purchase of land and buildings in England and Northern Ireland with a completion date falling on or after 1 March 2019. HM Treasury confirm that the majority of SDLT returns are already filed within 14 days.

*SDLT surcharge on overseas buyers*

In January 2019, the Government plan to publish a consultation document concerning the introduction of a 1% SDLT surcharge for non-UK residents who buy residential property in England and Northern Ireland.

*Contributed by Robert Jamieson*

## Administration

### Brexit causes late issue for online late filing notices

2017/18 paper tax returns were due by 31 October 2018, with online returns due by 31 January 2019. HMRC is expected to issue penalty notices for paper returns that are filed late within the usual timeframe but penalties for the late filing of online returns will be later than the usual. This decision is part of HMRC's contingency planning for Brexit that is intended to free up staff in its call centres and back office for EU Exit related work.

Normally, missing the online deadline would result in a taxpayer expecting to receive a fixed £100 late filing penalty notice in late February. Agent Update issue 70 says that the notices will be issued before the three month daily penalty begins to accrue, so before the end of April, but they will go out sooner if the Brexit Withdrawal Agreement is agreed.

*<https://www.gov.uk/government/publications/agent-update-issue-70>*

### Discovery stale or lack of information

*Summary – HMRC's discovery had not become stale by the time an assessment was issued and the taxpayer had been careless in completing their return by providing insufficient details.*

Richard Atherton was a partner in a hedge fund, having previously worked in financial institutions. The First Tier Tribunal considered that this background gave him "a reasonably good lay understanding of tax returns and tax matters".

Mr Atherton wanted to avoid tax on his 2007/08 partnership income of £5 million and so his accountant introduced him to NT Advisers, a company that marketed tax avoidance schemes. The company recommended the Romangate scheme. He understood that the scheme aimed to generate artificial employment losses, unrelated to his partnership, and that the scheme was risky.

Mr Atherton implemented the scheme, creating an employment loss in 2008/09. On his behalf, his accountant completed and submitted his 2007/08 tax return on 30 January 2009 including:

- The employment loss in Box 3 of the additional information pages, under the heading 'income tax losses' in respect of the sub-heading 'Relief now for 2008-9 trading, or certain capital, losses.'
- A disclosure in the white space referring to the entry in Box 3, stating that the entry related to a 2008/09 employment loss, acknowledging that this Box was for trading or capital losses and also including details of the Romangate scheme;
- The employment loss again, but this time capped at the amount of Mr Atherton's actual income, in Box 20 of the partnership pages, under the main heading: 'Your share of the partnership's trading or professional losses', with Box 20 itself headed 'Loss from this tax year set-off against other income for 2007-08'

His tax payable was reduced from just over £2 million to nil.

In 2009 HMRC opened an enquiry into the return under Sch. 1A TMA 1970 as an enquiry into a stand alone claim on his return.

In December 2013, NT Advisers wrote to HMRC accepting that because of retrospective legislative changes, the scheme was ineffective.

In 2014, as a result of the Supreme Court's judgment in *R & C Commrs v Cotter* [2013] BTC 837, HMRC decided that the Sch. 1A enquiry was invalid. Under the Cotter decision, the claim was 'in' Mr Atherton's 2007/08 return and consequently, an enquiry could only be raised under s9A TMA 1970 for which it was now too late.

Instead, HMRC issued a discovery assessment in March 2014 to assess the underpaid tax because the scheme was ineffective. Mr Atherton appealed to the First Tier Tribunal who found that the discovery assessment was valid as the:

- 2008/09 employment loss was included in Box 20 as a partnership loss for 2007/08, so he was effectively duplicating his Box 3 claim. There was no explanation for this Box 20 entry as his white space entry referred only to Box 3.
- insufficiency was discovered by HMRC when, following the *Cotter* judgment in late 2013 they discovered that the Box 20 entry comprised a part of the taxpayer's self-assessment (rather than a stand alone claim) and that it had effectively reduced the self-assessment to nil; Mr Atherton's self-assessment for 2007–08 was insufficient.

The First Tier Tribunal found that it was careless to have forced a 2008/09 claim into the 2007/08 return by using unrelated Box 20, without explanation.

Mr Atherton appealed to the Upper Tribunal.

### *Decision*

The Upper Tribunal agreed with the First Tier Tribunal that HMRC made a discovery in 2014. Although the 2014 discovery clearly related to the same issue as the 2009 discovery, namely the Romagate loss, it was a different discovery. The new discovery was that Mr Atherton should have been treated as having made a claim for relief 'in' his tax return rather than as a stand-alone claim 'on' his return.

The Upper Tribunal also agreed that the insufficiency was brought about carelessly, but interestingly, for different reasons. They should have asked whether Mr Atherton and his accountant had taken reasonable care to avoid bringing about the insufficiency. Given that neither Mr Atherton, nor his accountant, had received advice to use of Box 20 as they did from anyone acting other than on Mr Atherton's behalf, there was a failure to take reasonable care to avoid the insufficiency.

The taxpayer's appeal was dismissed.

*Richard Atherton v HMRC [2019] UKUT 0041 (TCC)*

## Deadlines

### 1 April 2019

MTD goes live for VAT periods beginning on or after 1 April 2019 for most businesses with annual taxable sales exceeding £85,000

Corporation tax due for APs ended 30 June 2018 for SMEs not liable to pay by instalments

### 5 April 2019

2018/19 tax year ends

Deadline to register to payroll benefits for 2019/20

### 6 April 2019

Personal allowances increased to £12,500

The lifetime allowance for pensions savings rises to £1,055,000

### 7 April 2019

Due date for VAT returns and payment for 28 February 2019 quarter (electronic)

### 14 April 2019

Quarterly corporation tax instalment for large companies depending on year end

Forms CT61 to be submitted and tax paid for the quarter ended 31 March 2019

### 19 April 2019

Payment of PAYE, NIC, CIS and student loan liabilities for month ended 5 April 2019 if not paying electronically

Payment of PAYE liability for quarter ended 5 April 2019 if average monthly liability < £1,500

### 22 April 2019

PAYE, NICs and student loan liabilities to have cleared HMRC's bank account

### 30 April 2019

Private companies' accounts with 31 July 2018 year end filed with Companies House

Public companies with 31 October 2018 year end filed with Companies House

CTSA returns for companies with accounting periods ended 30 April 2018 filed

## News

### Northern Ireland border checks in a no-deal Brexit

The government has announced plans for a 'unilateral, temporary approach' to checks, processes and tariffs in Northern Ireland if the UK leaves the EU without a deal. See:

[www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2019-03-13/HCWS1406](http://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2019-03-13/HCWS1406)

This would involve limited new requirements to declare goods from the EU to meet 'essential international obligations'. The UK government would continue to collect VAT and excise duty on goods arriving from Ireland. Small businesses below the VAT registration threshold would be able to report VAT online periodically, without new border processes. Irish businesses sending parcels to Northern Ireland would need to register with HMRC to pay import VAT. Northern Ireland businesses currently registered on the EU excise system would register on a UK equivalent.

*Tolley Guidance*

### Spring Statement 2019: 13 March (Lecture B1126 – 25.43 minutes)

The chancellor confirmed that, following the introduction of making tax digital (MTD) for VAT in April 2019, the government's focus will be on supporting businesses through the transition to digital reporting and record-keeping and it will not make MTD mandatory for any new taxes or businesses in 2020.

They also published papers on:

- Tackling tax avoidance, evasion and other forms of non-compliance setting out the government's approach and achievements in tackling tax non-compliance since 2010;
- Offshore tax compliance strategy following up developments since the previous 'no safe havens' strategy was published in 2014. It summarises HMRC's approach towards offshore tax compliance and is concerned with tackling multinational tax avoidance through international cooperation;
- A consultation running until 24 April 2019 on the structures and buildings allowance (SBA) draft secondary legislation that was published. Following comments made on the technical note changes have been made that include no withdrawal of relief for periods of disuse, demolition to be treated as a disposal event for CGT purposes, rather than claimed as 'shadow' SBA; and separate rules for wasting and non-wasting leases;
- An aggregates levy review on the way in which the aggregates levy is structured and currently operates.

Other a number of areas were highlighted where the government plans to either consult, feedback findings or publish draft regulations including:

- A consultation on lettings relief and the deemed final period exemption for PPR;
- Publication in the coming months of draft legislation on the knowledge-intensive fund structure within the enterprise investment scheme rules, expected to be introduced from 6 April 2020.

*[www.gov.uk/government/publications/spring-statement-2019-written-ministerial-statement](http://www.gov.uk/government/publications/spring-statement-2019-written-ministerial-statement)*

## **GAAR opinion on film-related losses and split sale of partnership**

*Summary - The GAAR advisory panel's conclusion was that the entering into and carrying out of the arrangements was not a reasonable course of action in relation to the relevant tax provisions.*

The taxpayer was a member of a limited liability partnership (LLP) set up for the purpose of 'acquiring and exploiting a portfolio of qualifying British films'. The LLP used member capital contributions, funded by capital account contribution loans from a UK bank, to enter into a sale and leaseback arrangement with a film studio. The sale and leaseback arrangements, under which lease rentals were payable to the LLP, generated a large loss in the LLP in 2006/07. The taxpayer claimed loss relief against his other income in that tax year.

The LLP members entered into refinancing arrangements during 2013/14 that split the sale of their LLP capital accounts (effectively the benefit of future drawings from LLP profits) from the sale of their residual interest in the LLP.

The taxpayer sold his LLP capital account to the capital account purchaser for market value. The purchaser acquired the economic benefit of the taxpayer's future LLP drawings, while the taxpayer retained the legal entitlement to future drawings and to his LLP interest. This was followed by the sale of the taxpayer's LLP interest to an interest purchaser for £1. Each member made a £40,000 contribution to the LLP, to which the interest purchaser was entitled following the sale.

### *Decision*

The panel agreed with HMRC that the arrangement was an attempt by the taxpayer to avoid income tax on the sale relating to future LLP income on which he was taxable under the original arrangements. The up-front tax deduction given on the capital account contribution loan was a relief in the form of a deferral.

The taxpayer was subject to income tax on future profits derived from the rental payments to the LLP. Anti-avoidance legislation was in place to ensure that proceeds from the sale of rights to future profits should have been treated as taxable income.

The panel concluded that:

- entering into of the tax arrangements was not a reasonable course of action in relation to the relevant tax provisions; and
- carrying out of the tax arrangements was not a reasonable course of action in relation to the relevant tax provisions.

*[www.gov.uk/government/publications/gaar-advisory-panel-opinion-of-25-january-2019-individuals-claiming-relief-for-film-related-losses-and-split-sale-of-interest-in-partnerships](http://www.gov.uk/government/publications/gaar-advisory-panel-opinion-of-25-january-2019-individuals-claiming-relief-for-film-related-losses-and-split-sale-of-interest-in-partnerships)*

*Adapted from Tolley Guidance (LNB News 24/02/2019)*

## **Consultation - HMRC a preferential creditor in insolvency**

Prior to 2003, HMRC was classed as a preferential creditor for certain taxes, but the Enterprise Act 2002 reduced HMRC's status to that of non-preferential creditor for all forms of tax. HMRC has continued to be a non-preferential creditor since 2003.

Broadly, asset realisations are paid out in the following order:

- Secured creditors with a fixed charge (after costs of realisation);
- Insolvency practitioners' fees and expenses;
- Preferential unsecured creditors;
- Prescribed part creditors;
- Secured creditors with a floating charge;
- Non-preferential unsecured creditors;
- Shareholders or individual.

The government announced at Autumn Budget 2018 that it will introduce legislation to make HMRC a secondary preferential creditor for taxes paid by employees and customers. This measure would protect the payment of tax debts for PAYE (including student loan repayments), NIC (employee contributions only), CIS and VAT that are due at the commencement of the insolvency.

HMRC is now consulting on the introduction of legislation in Finance Bill 2020 to restore the department's position as a preferential creditor in company insolvencies for certain tax debts, including VAT, PAYE, employee NICs and CIS deductions with effect for insolvencies that commence from 6 April 2020.

The rules will remain unchanged for liabilities relating to taxes directly levied on businesses or individuals themselves, such as Income Tax, Capital Gains Tax, Corporation Tax and Employer National Insurance Contributions. HMRC will continue to be a non-preferential unsecured creditor in respect of these tax debts.

The consultation runs for 12 weeks, starting on 26 February 2019 and ending on 27 May 2019.

*[www.gov.uk/government/consultations/protecting-your-taxes-in-insolvency](http://www.gov.uk/government/consultations/protecting-your-taxes-in-insolvency)*

## **Spotlight 49: Disguised Remuneration: Schemes Claiming To Avoid The Loan Charge**

HMRC is aware of schemes being marketed offshore from locations such as Cyprus, Malta or Isle of Man, claiming to avoid the disguised remuneration loan charge as under these schemes loans created will be paid off.

Promoters of these schemes are claiming that the scheme is not disclosable under the Disclosure Of Tax Avoidance Schemes regime, and in some cases, have benefited from a QC opinion.

However, HMRC say that people should be aware of any arrangement that suggests a disguised remuneration loan can be 'paid off' or 'repaid' without a real economic consequence to the transaction – suggesting that the scheme user will not suffer any material financial cost (apart from fees).

*[www.gov.uk/guidance/disguised-remuneration-schemes-claiming-to-avoid-the-loan-charge-spotlight-49](http://www.gov.uk/guidance/disguised-remuneration-schemes-claiming-to-avoid-the-loan-charge-spotlight-49)*

## **Ten jurisdictions added to tax havens blacklist**

The Council adopted a revised EU list of non-cooperative jurisdictions for tax purposes.

In addition to the 5 jurisdictions (American Samoa, Guam, Samoa, Trinidad and Tobago, US Virgin Islands) that were already listed, the revised EU list of non-cooperative jurisdictions now also includes the following 10 jurisdictions: Aruba, Barbados, Belize, Bermuda, Dominica, Fiji, Marshall Islands, Oman, United Arab Emirates, Vanuatu.

Those jurisdictions did not implement the commitments they had made to the EU by the end of 2018.

Annex II of the conclusions, which covers jurisdictions with pending commitments, also reflects the deadline extensions granted to 11 jurisdictions to pass the necessary reforms to deliver on their commitments.

*[www.consilium.europa.eu/en/press/press-releases/2019/03/12/taxation-council-revises-its-eu-list-of-non-cooperative-jurisdictions/](http://www.consilium.europa.eu/en/press/press-releases/2019/03/12/taxation-council-revises-its-eu-list-of-non-cooperative-jurisdictions/)*

## Business Taxation

### Lorraine, an entertainer (Lecture B1126 – 25.43 minutes)

*Summary – Services provided by Lorraine Kelly to ITV were provided under a contract for services and did not fall foul of the IR35 legislation.*

Albatel Ltd is the personal service company of Mr and Mrs Smith, with the appeal concerned with Mrs Smith, otherwise known as Lorraine Kelly. Albatel Ltd contracted to provide the services of Lorraine Kelly to ITV Breakfast Ltd as a presenter in connection with the television programmes “Daybreak” and “Lorraine”.

“Lorraine” is an entertainment show that is taken off air if a news story breaks overnight or early in the morning. Lorraine Kelly claimed that she decides on guests, content and running order. There have been many occasions over the years where she has dressed up and re-enacted movie scenes in skits and sketches, the aim of which is to set up the guests in an entertaining way and keep people watching. She explained that she will often go to movie screenings, previews of plays or read books in order to prepare for guests on the show; this is entirely Ms Kelly’s choice. Other presenters often rely on members of their team to prepare a brief and questions whereas Ms Kelly carries out her own research and prepares the interview. Ms Kelly supplies her own phone and iPad and ITV contacts her via a personal email address or mobile phone number. She undertook an expedition to Antarctica in 2017 for which she was absent from the show for 4 weeks in addition to the 10 weeks holiday specified in the contract.

In respect of “Daybreak” Ms Kelly explained that it was a magazine show with ‘soft news’ content and human-interest stories. She believed that her role and involvement was the same as for “Lorraine”. The screen tests for a co-presenter took place in Dundee for her convenience and she chose the co-presenter, Aled Jones. She agreed that “Daybreak” was not classified as entertainment but stated that her role on the show was that of an entertainer with features of dressing up and doing sketches with Aled Jones. She stated that she viewed the term “theatrical artist” widely and that she acted everyday as a version of herself.

She explained that she can work for any other broadcaster, having recently filmed a documentary on penguins in South Africa for Channel 5. ITV are under no obligation to pay her if she is unable to present the show.

HMRC submitted that she fell into the category of persons who can have both an employment and separate self-employed income. HMRC compared this case with the Christa Ackroyd case (see our March 2018 notes) in which the Tribunal accepted that Christa Ackroyd was expected to drive ratings, was involved in the look, feel and approach of the programme, was a very successful television journalist and presenter, was more than just a newsreader and had a high degree of autonomy. Nevertheless the Tribunal found that the BBC retained the contractual right of control, consistent with employment.

HMRC submitted that what matters is where the right of control lies, which they believed would be with ITV under this hypothetical contract. ITV is ultimately responsible for the output, it has the right to reject any editorial suggestions made by Lorraine Kelly, for example as to which stories to run or people to interview. The fact that a situation has not arisen where ITV has exercised that right does not mean that the right does not exist.

HMRC accepted that in other work Lorraine Kelly was self-employed but, viewed as a whole, Ms Kelly's situation here was one of substantial part time employment. HMRC concluded that had there been a direct contract between Lorraine Kelly and ITV Breakfast Ltd it would have been a contract of service, meaning it fell foul of the intermediaries legislation, resulting in the need to account for income tax and NICs totalling £1.2 million.

If this was the case, HMRC also argued that agency fees paid by Albatel Ltd to Roar Global Ltd (Lorraine Kelly's agent) for negotiating the agreement between Albatel Ltd and ITV were not deductible as an expense of the employment. They argued that, to be deductible, the expenses needed to be paid by Lorraine Kelly and not Albatel Ltd. Further, HMRC argued that the expenses needed to relate to an "entertainer" so "an actor, dancer, musician, singer or theatrical artist". HMRC submitted that it is not enough for an individual to be a performer or entertainer; it must be shown that the individual is performing "with a theatrical bent" or "in a manner of acting or theatre".

Albatel Ltd appealed arguing that it was a contract for services and the IR35 rules did not apply. Although the decision on the deductibility only arises if the intermediary rules apply, the Tribunal were asked to set out their findings on this issue irrespective of their decision.

### *Decision*

The Tribunal concluded that Lorraine Kelly was very much in control. She had little supervision; she decided the running order of the programme, the items to feature and the angle to take in interviews. It was her decision to stay on site after each show and lead meetings about the following day's show; She was hired to lead a team and was engaged to use her skills as she saw fit and with a free rein. The Tribunal were satisfied that she was free to carry out other work and activities without any real restrictions.

Although there was no scope for her to increase profits, she was exposed to the type of risk that would be found in self-employment, such as the programme being dropped or long-term sickness rendering her unable to provide her services.

Lorraine Kelly carried out a variety of other work from writing to designing and advertising a fashion line. She also appeared on other television shows. These considerable and varied activities were strong indicators that she was providing services in business on its own account. The Tribunal concluded that ITV was not employing a "servant" but rather purchasing a product, namely the brand and individual personality of Lorraine Kelly. A number of other factors only served to strengthen the argument. She was not entitled to sick pay, holiday pay or other employee benefits; she received no training or appraisals and was under no obligation to provide other services to ITV unrelated or ancillary to the show. In looking at the overall picture the Tribunal concluded that the relationship between Ms Kelly and ITV was a contract for services and not that of employer and employee.

As requested, the Tribunal went on to consider the ancillary issue relating to the deductibility of agency fee, despite it having no bearing on the outcome of this case. The question was whether the contract related to Ms Kelly or Albatel Ltd or both. All parties considered that Ms Kelly and Albatel Ltd were one and the same. The Tribunal took the view that a contract existed between ROAR Global and Ms Kelly and the fact that the invoices were paid through Albatel Ltd did not matter.

Secondly, it was clear to the Tribunal that neither the programmes nor her role in them could be viewed as current affairs or programmes of a similar nature but rather:

“for the time Ms Kelly is contracted to perform live on air she is public “Lorraine Kelly”; she may not like the guest she interviews, she may not like the food she eats, she may not like the film she viewed but that is where the performance lies, as no doubt with other entertainers such as Ant and Dec or Richard and Judy.”

On this basis the Tribunal concluded that she is a “theatrical artist” making her expenses tax deductible.

*Albatel Limited v HMRC (TC07045)*

### **Under-declared trading profits (Lecture B1126 – 25.43 minutes)**

*Summary – HMRC’s discovery had not become stale when assessments were eventually issued following the failure of negotiations with the taxpayer.*

Osman Chaudhary carried on a second-hand car sales business between 2008 and 2013.

HMRC opened an enquiry into his self-assessment tax return for the tax year ended 5 April 2011 and concluded that the profits from the business were understated. Consequently, HMRC amended his self-assessment for the tax year ended 5 April 2011 and issued discovery assessments for each of the tax years ended 5 April 2009, 5 April 2010 and 5 April 2012. The total amount of additional tax assessed was just under £75,000. In addition, HMRC imposed penalties of just over £57,000 on the basis that the inaccuracies in the returns were deliberate and concealed.

Mr Chaudhary accepted that the figures shown in his tax returns were incorrect but he appealed against the discovery assessments and the amendment to his self-assessment on the basis that the figures for his profits/losses should be in accordance with accounts that he provided to HMRC during the course of the enquiry. He also claimed that HMRC should have used a lower penalty percentage to take into account his co-operation during the enquiry.

It is worth noting that:

- During the course of this enquiry, HMRC issued six taxpayer information notices requiring Mr Chaudhary to produce information which had previously been requested by HMRC but which Mr Chaudhary had failed to provide.
- On numerous occasions during the enquiry HMRC pressed Mr Chaudhary to confirm that he had disclosed to them all of his bank accounts including asking him several times to sign a “certificate of bank accounts operated”. Mr Chaudhary failed to sign the relevant certificate until 17 January 2015 and, in the meantime, gave answers to HMRC which inferred that he had disclosed all of the relevant bank accounts.
- In January 2014, HMRC issued third party information notices to Santander and to HSBC. As a result of this, they became aware of six bank accounts with HSBC in Mr Chaudhary’s name into which in excess of £1.5 million had been deposited during the period 2008 – 2011.

HMRC said that the discovery of an under assessment to tax took place when they reviewed the HSBC bank statements in the summer of 2014. Had this become stale by the time the assessments were made in January 2017?

### *Decision*

The Tribunal accepted that the discovery had not become stale as a result of the time that elapsed between the making of the discovery and the making of the assessments. HMRC could not be required to make discovery assessments while they were actively pursuing their enquiries with a view to trying to reach a settlement with the taxpayer.

The First Tier Tribunal concluded that Mr Chaudhary's failure to disclose the bank accounts had been deliberate and concealed but they did allow an adjustment in respect of some of the assessments as it disagreed slightly with HMRC's calculations.

*Usman Chaudhary v HMRC (TC06982)*

## **Income tax and sideways loss relief (Lecture P1128 – 21.44 minutes)**

The First-Tier Tribunal decision in *Naghshineh v HMRC (2018)*, which went in favour of the taxpayer, considered the impact of the ITA 2007 'reasonable expectation of profit' test in connection with substantial losses incurred over a number of years by a farming sole trader (Mr N).

The case was an appeal by Mr N against closure notices issued by HMRC on 7 May 2014 in respect of his farm's years ended 31 March 2008 through to 31 March 2012. The trading losses for the years under appeal were (per HMRC):

	£
Year ended 31 March 2008	422,244
Year ended 31 March 2009	521,680
Year ended 31 March 2010	390,174
Year ended 31 March 2011	101,697
Year ended 31 March 2012	28,529

HMRC determined that the sideways loss relief claimed by Mr N for each of those years should be denied. This resulted in additional income tax payable, in comparison with the original self-assessments, of almost £600,000.

Mr N was a successful businessman with a wide range of activities who, in 1995, purchased a 75-acre working farm north of Norwich. He had no previous experience of agribusiness and so he employed a farm manager and, at a later stage, a general manager. Early on in Mr N's ownership of the farm, he realised that he could obtain premium prices for organic farm produce compared to conventional produce (which is how the farm had hitherto been operated) and he therefore decided to convert the farm to organic production.

He also formed the view that the farm was unlikely to be economically viable without increasing its size significantly so that he could then obtain the benefits of scale. With this in mind, he made the following further purchases of land:

1998	221 acres of agricultural land
2000	89 acres of agricultural land
2007	25 acres of agricultural land
2007	a 28-acre apple orchard

In the years with which this appeal is concerned, Mr N's farm therefore extended to 438 acres.

The losses which arose were partly due to a downturn in the organic food business resulting from the financial crisis in the first decade of the present century, but they were also caused by the generous way in which Mr N remunerated his farm workers who were paid on a similar basis to the workers in his other unrelated enterprises.

Mr N's agricultural activities had made losses in every tax year since he started the business up to 2011/12. His first profit was in 2012/13 and the business was profitable thereafter. Sideways relief under S64 ITA 2007 was claimed against Mr N's general income. Although there is a special 'five-year rule' for farming losses in S67 ITA 2007 (beyond which sideways relief is not given), this restriction does not apply if the farming activities meet the 'reasonable expectation of profit' test in S68 ITA 2007. It is this provision with which the case is concerned.

The legislation in S68 ITA 2007 can be summarised as follows:

- The test is decided by reference to the expectations of a hypothetical competent farmer carrying on the farming activities (S68(2) ITA 2007).
- The first requirement for this test to be met is whether or not the hypothetical competent farmer had, in the current tax year, a reasonable expectation of profits in the future (S68(3)(a) ITA 2007).
- The second part of the test involves consideration of whether the hypothetical competent farmer carrying on the farming activities at the start of the loss-making process could not reasonably have expected those activities to become profitable until after the end of the current tax year (S68(3)(b) ITA 2007).

It is instructive to examine the First-Tier Tribunal's analysis of the two limbs of the test in S68(3) ITA 2007, which ended up allowing Mr N's appeal, but, before we do so, a really important point to note is that the First-Tier Tribunal had the benefit of (and relied heavily on) the written and oral evidence of an expert in the field of farming operations and profitability (a Mr William Waterfield). Mr Waterfield was appointed by Mr N, but both sides agreed that he was a credible expert in this area. As the two tests in S68(3) ITA 2007 require consideration of farming competence and profitability, it was definitely an astute strategy on Mr N's part to have presented this expert evidence. The result could well have been different in the absence of Mr Waterfield's report.

With reference to S68(3)(a) ITA 2007, HMRC accepted that this part of the test was met for 2010/11 and 2011/12, but they contended that, in the preceding three tax years, costs had been allowed to spiral out of control and also that the farming activities had become too diverse. HMRC argued that a competent farmer could not have expected to make profits in the future because of the high level of those costs.

Mr Waterfield's report disagreed with HMRC and stated that, in each of the tax years under consideration, the hypothetical competent farmer would have had a reasonable expectation of future profits.

Swayed by this, the First-Tier Tribunal rejected HMRC's submission that the farmer would have been unable to make a profit because of the farm's high cost structure on the ground that, at a later stage, he could always have reduced the level of his overheads (just as Mr N had actually done) such that he would then have had a reasonable expectation of future profit.

As far as S68(3)(b) ITA 2007 was concerned, the First-Tier Tribunal followed the reasoning of the Upper Tribunal in *Scambler v HMRC* (2017) and therefore did not take into account unforeseen and unforeseeable events which had affected Mr N's farming operation. However, they held that it was reasonable for the hypothetically competent farmer to allow a contingency for any such events and that this contingency would inevitably have the effect of prolonging the time by which the farming venture became profitable. Using Mr Waterfield's timeline on expected profitability as a starting-point, the First-Tier Tribunal found that it would have taken the hypothetical competent farmer the following lengths of time to move into profit:

Finding and acquiring the necessary land	3 – 5 years
Conversion of the land to organic status	4 years
Producing a wide range of farming products	4 – 10 years
Selling farm produce directly to the consumer	4 – 10 years
Achieving profitability	10 years from converting to organic status

Given that Mr N's first fully organic harvest was in 2003, this last point suggests that the business would not become profitable until 2013. Therefore, Mr N satisfied the second limb of S68(3)(b) ITA 2007 for all the years up to and including 2011/12. As a result, he was entitled to his sideways loss relief under S64 ITA 2007.

The value of the expert witness evidence in this case cannot be overemphasised.

*Contributed by Robert Jamieson*

## Replacement plant and machinery

Turners (Soham) Ltd (Turners) were a road haulage company that in the years 2008-2011 purchased replacement trailer units, tractors and tank units totalling £33M. In their accounts they capitalised the acquisitions and put a depreciation charge to profit and loss in each period. In their tax computation for 2008 they initially claimed capital allowances but then in 2011 they amended their tax computation for 2008 by disclaiming the capital allowances and claimed a full deduction for the cost against their trading profits. They also made an overpayment claim under FA 1998, Sch 18 para 51. A similar amendment was made to 2009 tax computation and no claims for capital allowances were made in subsequent years.

The company argued that the deduction claimed for the year to 2008 was based on ICTA s74(1)(d) which stated that:

*'Subject to the provisions of the Corporation Tax Acts, in computing the amount of profit to be charged under Case I or II of schedule D no sum shall be deducted in respect of ...*

*(d) any sum expended for repairs of premises occupied, or for the supply, repairs or alterations of any implements, utensils or articles employed for the purposes of the trade or profession beyond the sum actually expended for those purposes;'*

The basis for the argument was that by denying a deduction for amounts beyond those actually expended, the section implicitly permits deduction for expenditure up to that point and that this would include capital expenditure. The FTT noted that if a deduction is to be claimed for an item the first step is to see if it is deducted in the accounts of the trade; if it has been, the second step is to see if its deduction is prohibited and the third step, if the first two do not result in a deduction, is to see if there is any express provision under which deduction is required. They concluded that, as there was no deduction in the accounts and that the deduction would be prohibited as capital, there should be no deductible amount for the replacement items. Section 74 was prohibitive to restrict a deduction for amounts expended but did not therefore allow provision for capital amounts up to the limit.

For the subsequent years, the company claimed relief under CTA 2009, s 68 which allowed a deduction for the expenses incurred on the replacement of trade tools which would otherwise not be allowable because they were capital in nature. The discussion centred around the meaning of 'expenses incurred' and the FTT took the view that this should mean there was a debit in the accounts of the company under GAAP. As this was not the case here there could be no deduction. They also noted that tractor and trailer units would not fall to be treated as tools as used in common language.

Lastly the FTT rejected the claim for overpayment made by the company because HMRC are not liable to give effect to such a claim where the liability was calculated in accordance with generally prevailing practice at the time. As there was a generally agreed practice of claiming capital allowances on such replacement items HMRC were not liable to meet the company's claims for an overpayment of tax.

It should be noted that s68 CTA 2009 was repealed in relation to expenditure incurred on or after 1 April 2016 for corporation tax purposes. Relief is now available for most items under the existing capital allowances regime or the relief for residential landlords for replacement of furnishings, appliances and kitchenware, which took effect from the same date.

Turners (Soham)Ltd v HMRC [2019] UK FTT 131

*Contributed by Joanne Houghton*

## **Sole trader, partnership or company? (Lecture P1129 – 11.43 minutes)**

A common question asked of us by clients who are starting in business is “Should I be a Sole Trader or a Limited Company?” or words to that effect. In the case of two people venturing into business together – such as a husband and wife – the word “Partnership” can also be thrown into the mix.

The answer of course – as it usually is to questions of this nature – is the old chestnut, “It Depends”.

“It Depends” on profit levels, how much the proprietors wish to draw from the business, whether the clients have other income sources, whether the concept of limited liability is important to them, what their long-term succession plans are and whether they have the organisational discipline to deal with the extra compliance burdens placed on them by running a business through a company.

With all these factors, there can never be a “One Size Fits All” solution, particularly as the optimum choice of business medium will often change as the business develops and matures.

To give us a general picture of how to decide on a business vehicle, these notes will take a small business, run jointly by a husband and wife, and look at the net distributable post-tax profits which are available to be drawn by the owners based on whether the business is either run:

- (a) By one of the parties as a Sole Trader with the other acting as an employee;
- (b) By the parties as 50:50 Partners;
- (c) By the parties as 50:50 director / shareholders of a Limited Company.

We will look at distributable post-tax profits from a range of profit levels between £20,000 and £150,000. This should give us a big enough sample size to draw some conclusions.

In all cases we will assume that:

- 2018/19 UK (non-Scottish) rates and allowances apply;
- FA18 corporation tax rates apply (being 19%);
- Any salaries / director’s fees are paid at the level of the Class 1 NIC primary and secondary earnings threshold (£8,424) as this creates an entitlement to retirement benefits without triggering a NIC liability for the employee or the business (with the added bonus that the salary is tax-deductible). We will assume that sufficient care is taken by the business not to contravene National Minimum Wage legislation;

- The client has no other income (so the personal allowance of £11,850 is available against business income); and
- Post-tax profits are fully distributed to the owners either as drawings or dividends.

When doing all of this we do recognise that we are allowing the tax tail to wag our business dog, but we are tax people after all so please indulge us.

The Answer...

Here is a Table that shows the comparable results for post-tax profits available to the proprietors from the various business mediums based on a business owned and managed by a husband and wife team on business profits ranging between £20,000 and £150,000.

The detailed workings behind the numbers are in the Appendix at the end of this article.

Business profit (before salaries):	Post-tax spendable profits		
	Sole Trader	Partnership	Limited Company
	£	£	£
£20,000	19,563	19,410	19,401
£35,000	30,268	30,800	31,551
£50,000	40,918	41,450	43,701
£100,000	70,539	76,002	82,714
£150,000	95,799	105,002	119,801

What conclusions can we draw?

- Trading through the vehicle of a limited company offers consistent tax savings and maximises post-tax profits at profit levels over £20,000 with tax savings increasing in the higher profit ranges. However, if we factor in the additional compliance costs (in both money and time) of running a limited company, there is a good argument for retaining an unincorporated structure while profit levels remain at no more than £35,000 - £40,000. This does not, of course, factor in the issue of limited liability protection on which it is difficult to put a price.
- The above comparisons assume that all post-tax profits are distributed to the shareholders as dividends. Retaining profits in the company structure will save tax at the higher profit levels as income tax liabilities at 32.5% is avoided. In these cases, the most tax-efficient strategy is likely to be to draw sufficient dividends to utilise the shareholder's basic rate band without triggering a higher rate income tax charge. This will allow each shareholder / director to extract a salary of £8,424 and a dividend of £37,926.
- This allows total drawings of £46,350 x 2 = £92,700 at a tax cost of just £2,427 x 2 = £4,854 (an effective personal tax rate of a little over 5%). For businesses with profits big enough to absorb this level of drawings, this is hard to beat.

Corporate structures offer the easier way to pass the business to the next generation or to involve a family member by giving away an equity stake while still retaining control.

So, “Should I be a Sole Trader or a Limited Company?”. The answer is probably to start off as an unincorporated business, particularly if early year losses are anticipated whilst the business is investing in its future and establishing its place in the market. The loss set-off rules for individuals are far more generous than for companies as losses in the first 4 tax years can be carried back 3 years against general income to generate repayments.

Then as the business grows, profits increase and the legal issues get more complicated, incorporate the business and work under the umbrella of limited liability protection with added tax savings to boot.

#### APPENDIX - DETAILED WORKINGS

##### SOLE TRADER:

Trader employs wife / husband in the business on a salary of £8,424.

	£	£	£	£	£
Business profits	20,000	35,000	50,000	100,000	150,000
Less: Employee salary	(8,424)	(8,424)	(8,424)	(8,424)	(8,424)
Taxable	11,576	26,576	41,576	91,576	141,576
Income tax	Nil	2,945	5,945	24,990	49,730
Class 2 NIC	153	153	153	153	153
Class 4 NIC	284	1,634	2,984	4,318	4,318
Total tax & NIC	437	4,732	9,082	29,461	54,201
Net distributable	19,563	30,268	40,918	70,539	95,799

##### Notes:

- Salary must be paid and reasonably commensurate with duties performed.
- Where profits are £150,000, personal allowances are reduced to nil.
- Class 2 NIC no longer due for abolition.
- Net distributable amount includes the employee salary (as retained in family).

**PARTNERSHIP:**

Profits split 50:50 between husband and wife

	£	£	£	£	£
Business profits	20,000	35,000	50,000	100,000	150,000
50% each	10,000	17,500	25,000	50,000	75,000
Income tax	Nil	1,130	2,630	8,360	18,360
Class 2 NIC	153	153	153	153	153
Class 4 NIC	142	817	1,492	3,486	3,986
Total tax & NIC	295	2,100	4,275	11,999	22,499
x 2	590	4,200	8,550	23,998	44,998
Net distributable	19,410	30,800	41,450	76,002	105,002

**Notes:**

- The tax position would be the same if the business was run as a Limited Liability Partnership (LLP) with the members then being entitled to limited liability protection.
- This assumes each partner plays an active role in the business and that HMRC does not seek to reallocate profits under the settlements legislation.

**LIMITED COMPANY:**

Husband and wife as 50:50 shareholder / directors.

Each takes a director's fee of £8,424.

Balance of profits distributed by dividend.

	£	£	£	£	£
Business profits	20,000	35,000	50,000	100,000	150,000
Less: Director's fees	(16,848)	(16,848)	(16,848)	(16,848)	(16,848)
Liable to corporation tax	3,152	18,152	33,152	83,152	133,152
CT @ 19%	599	3,449	6,299	15,799	25,299
Balance paid as dividends	2,553	14,703	26,853	67,353	107,853
50% each	1,276	7,351	13,426	33,676	53,926
Income tax	Nil	Nil	Nil	1,487	4,900
Net distributable	19,401	31,551	43,701	82,714	119,801

## Notes:

- £2,000 dividend allowance applies.
- No NIC on dividends.

### Capital allowances changes (Lecture B1127/ B1128 – 17.01/ 11.41 minutes)

Various amendments have been made to the capital allowances regime in the Budget on 29 October 2018 (Now Finance Act 2019). The main ones involve:

- the introduction of a structures and buildings allowance (SBA) for new non-residential buildings;
- reducing the WDA from 8% to 6% for assets falling into the special rate pool;
- a temporary increase in the maximum amount of 100% AIAs from £200,000 to £1,000,000;
- the abolition of the 100% enhanced capital allowances (ECAs) rules for expenditure on certain energy-saving and water efficient plant or machinery; and
- a four-year extension to the special 100% FYAs for expenditure on electric charge-points.

After the relatively minor capital allowances changes in recent years, the reforms announced by the Chancellor on 29 October 2018 (Now Finance Act 2019) are wide-ranging and represent the most significant amendments to the capital allowances code since 2008.

The Government have been swift to act on the Office of Tax Simplification's recommendations following the consultation on capital allowances earlier this year and the Government's aim of improving the UK's international competitiveness and encouraging investment will be warmly welcomed by UK businesses and investors at a time of increasing uncertainty.

### *SBA – key features*

The main features of this investment incentive, which is significantly broader than the old industrial buildings allowances legislation, are as follows:

- relief will be given at a flat rate of 2% over a 50-year period;
- relief will be available for all new commercial structures and buildings (including the costs of new conversions and renovations);
- all relevant structures and buildings, whether situated in the UK or overseas, will qualify, provided that the business which incurred the expenditure is within the charge to UK tax;
- relief will be limited to the costs of physically constructing the structure or building (including the costs of any demolition or land alterations necessary for such construction), together with any direct costs which are required in order to bring the asset into existence;
- relief will be available for eligible expenditure incurred where the contracts for the construction works are entered into on or after 29 October 2018;
- claims can only be made from when a structure or building first comes into use;
- land costs will not be eligible for relief nor will the costs of obtaining planning permission;
- the claimant must have an interest in the land on which the structure or building is put up;
- dwelling houses will not qualify nor will any part of a building used as a dwelling where the rest of the property is commercial;
- the sale of a property qualifying for the SBA will not give rise to a balancing allowance or balancing charge – instead, a second-hand purchaser will simply take over the residual 2% allowances for the remaining 50-year period;
- expenditure on integral features will continue to be allowable as before, ie. such items will qualify for AIAs and special rate pool WDAs; and
- SBA expenditure will not be eligible for AIAs.

For SBA purposes, structures and buildings include offices, retail and wholesale premises, factories, warehouses, walls, bridges and tunnels. Capital expenditure on the renovation or conversion of existing commercial structures and buildings will, as mentioned above, also qualify. HMRC add:

‘The costs of construction will include only the net direct costs related to physically constructing the asset, after (taking into account) any discounts, refunds or other adjustments. Capital expenditure does not include costs that can be allowed as a deduction in calculating the profits of the business.’

#### *WDAs for assets falling into special rate pool*

Certain capital expenditure nowadays only qualifies for WDAs at a special rate of 8%, calculated on a reducing balance basis. This is known as ‘special rate expenditure’. The main items that fall into this special rate pool are expenditure on:

- (i) thermal insulation;
- (ii) integral features of buildings and structures;
- (iii) long-life assets;
- (iv) cars with CO<sub>2</sub> emissions > 110g/km (130g/km if incurred pre 1 April 2018); and
- (v) expenditure on solar panels.

Although the main WDA rate stays at 18%, the Chancellor has decided that, as a quid pro quo for the introduction of the SBA, the special rate pool WDAs should be reduced from 8% to 6%. This will take effect from 1 April 2019 (for corporation tax) and 6 April 2019 (for income tax).

For chargeable periods spanning the relevant starting date, the WDA rate will be an average of the rates before and after the change. So, for a company with calendar year accounting periods, the special rate pool WDA for the year ended 31 December 2019 will be:

$$(3/12 \times 8\%) + (9/12 \times 6\%) = 6.5\%$$

One’s initial feeling is that, for many clients, the benefit of the new SBA will be significantly outweighed by the drop in this form of WDA. However, small businesses will still be able to cover most of their special rate expenditure by a claim for 100% AIAs in the period in which that expenditure is incurred.

#### *New AIA limit*

Since 1 April 2008 (for companies) or 6 April 2008 (for sole traders and partnerships), most businesses, regardless of size, have been able to claim 100% AIAs on their expenditure on plant or machinery – other than on cars – up to a specified annual amount each year.

With effect from 1 January 2016, the maximum AIA entitlement was set at what was meant to be a permanent limit of £200,000 by F(No2)A 2015.

Despite this, on 29 October 2018, the Chancellor announced that the AIA limit was to be increased fivefold to £1,000,000 on 1 January 2019 for a temporary period of two years. On 1 January 2021, the cap will go back to £200,000. This temporary measure is designed, in the words of HM Treasury, 'to stimulate growth in the economy by providing an additional time-limited incentive for businesses (particularly medium-sized businesses) to increase, or bring forward, their capital expenditure on plant or machinery'.

Where a business has a chargeable period that spans the operative date of the increase, the maximum allowance for that period comprises two parts:

1. the AIA entitlement, based on the £200,000 limit, for the portion of the period falling before 1 January 2019; and
2. the AIA entitlement, based on the temporary cap of £1,000,000, for the portion of the period falling on or after 1 January 2019.

In other words, it will be a time-based calculation. However, it is important to note that the AIA for any capital expenditure incurred in the period before 1 January 2019 is restricted to a maximum of £200,000 (where the actual expenditure was greater), given that this was the upper limit claimable prior to the temporary increase.

#### *Abolition of 100% ECAs*

From 31 March 2020 (companies) and 5 April 2020 (unincorporated businesses) the scheme, that currently provides a 100% first year deduction for expenditure on qualifying energy-efficient and water saving plant or machinery, is to be abolished. The removal of this relief is particularly disappointing given that first year tax credits for loss-making companies were extended by S29 FA 2018 for a further five years through until 31 March 2023.

Having said that, the products on the Energy Technology List and the Water Technology List will be updated next year for one last time to reflect developments in eligible plant or machinery. It is understood that the revenue saved by this change of policy will be used to fund the Industrial Energy Transformation Fund.

#### *100% FYAs for expenditure on electric vehicle charge-points*

The 100% FYA regime in S45EA CAA 2001 for expenditure incurred on new charge-point equipment for electric vehicles is being extended for four more years to 31 March 2023 (for corporation tax) and 5 April 2023 (for income tax).

This measure is, in the words of HM Treasury, 'designed to encourage the use of electric vehicles by supporting the development and installation of electric charging equipment (for) such vehicles'. It is intended to promote the use of cleaner vehicles by making electric charge-points a more common feature and complements the 100% FYAs for expenditure on:

- cars with low CO<sub>2</sub> emissions (S45D CAA 2001); and
- zero-emission goods vehicles (S45DA CAA 2001).

*Contributed by Robert Jamieson*

## **Income tax to be deducted from creditors' statutory interest**

The Supreme Court upheld the Court of Appeal's decision in favour of HMRC.

Statutory interest (i.e. in an administration or liquidation) payable by Lehman Brothers International (Europe), a company in administration, under rule 14.23(7) of the Insolvency (England and Wales) Rules 2016 (SI 2016/1024) (or its predecessor, rule 2.88(7) of the Insolvency Rules 1986 (SI 1986/1925)) was yearly interest because the period commencing from when the company entered into administration and ending when the proven debts had been paid (i.e. the period by reference to which the statutory interest was calculated) exceeded a year and, therefore, any such payment was subject to an obligation to deduct income tax under section 874 of the Income Tax Act 2007 (ITA 2007).

Creditors of companies in administration or liquidation may therefore need to ensure they have taken advantage of any relevant reliefs or exceptions in relation to the tax withheld, even though at the outset of the administration or liquidation they do not know if the income tax will be withheld.

*Joint Administrators of Lehman Brothers International (Europe) (In Administration) v HMRC*  
[2019] UKSC 12

*Contributed by Joanne Houghton*

## **Spring statement corporate tax announcements**

Some additional corporate tax items in the Spring Statement documents included:

- Digital Services Tax - there will be a consultation on the detailed design and implementation of the new tax, which comes into effect on 1 April 2020
- Intangibles and Hybrids - regulations will be published for the new rules on offshore receipts in respect of intangible property and technical aspects of the hybrid and other mismatch rules
- Corporate capital losses - HMRC will publish a response to the consultation on corporate capital losses
- SME R&D – a consultation will be issued on an anti-avoidance measure to introduce a limit on the payable tax credit that a qualifying loss-making company can claim from 1 April 2020

*Contributed by Joanne Houghton*

## VAT

### **Flat Rate Scheme withdrawal (Lecture B1126 – 25.43 minutes)**

*Summary – The Tribunal was unable to conclude as to whether the company should be allowed to withdraw retrospectively from the Flat Rate Scheme and recover input tax on the purchase of leased vehicles.*

Apex Vehicle Management Limited's main activity was to provide courtesy cars following car accidents, so it effectively leasing cars. The company registered for VAT with effect from 1 June 2012 and on 15 July 2013 it applied to join the Flat Rate Scheme with effect from 1 March 2013. HMRC confirmed this. The rate applicable to such activities was 9.5 per cent with a 1 per cent reduction for the first 12 months.

Later the company looked to reclaim just over £40,000 of input VAT suffered on a number of vehicles bought to be used in the business but HMRC advised that this was not possible. Input tax can be reclaimed on capital goods costing £2,000 or more including VAT but, referring to Section 15 of VAT Notice 733 Flat Rate Scheme for small businesses, HMRC advised that this does not apply to capital goods that are leased, let or hired out by the business.

Subsequently, the company tried to withdraw retrospectively from the Flat Rate Scheme to enable it to claim the input tax on the vehicles through normal VAT accounting.

The company claimed that, based on their invoices raised, it had never been eligible to enter the Flat Rate Scheme because the value of its taxable supplies exceeded the relevant £150,000 threshold. The company produced invoices for the relevant period showing with total sales of £1.3 million, sought to cancel use of the scheme and return to the normal cash accounting VAT from 1 March 2013. It could then recalculate its VAT liability based on normal VAT accounting and claim the input tax on its vehicles.

However, HMRC refused the request. The invoices raised by the company were not relevant to its VAT returns because it had adopted the cash accounting scheme. Roughly three quarters of the invoices were unpaid with no explanation and there were also unexplained amounts on the invoices. This explained why the VAT return figures based on payments received were within the scheme threshold of £150,000, despite the sales invoices indicating that a much higher turnover had been achieved.

HMRC's policy on retrospective withdrawal from the Flat Rate Scheme is to allow it only if there are exceptional circumstances. They submitted that the request to backdate the operation of standard accounting to the 1 March 2013 was solely designed to reduce the VAT liability, which was not the purpose of the scheme or of the option to withdraw from it. The effective date of withdrawal should therefore be 30 June 2015, the date at which the company opted to withdraw from the scheme.

### *Decision*

The First Tier Tribunal stated that the Flat Rate Scheme application form required Apex Vehicle Management Limited to declare that it was eligible for the scheme. HMRC took the company at its word on this, presumably without knowing of the significant value of invoiced but unpaid supplies, given the use of cash accounting. The Tribunal accepted that admission to the Flat Rate Scheme may therefore have come about through a mistake on the part of both parties. Based on the evidence, the Tribunal was unable to say whether the company was never eligible for admission to the Flat Rate Scheme and entered the scheme by mistake. For most businesses this would not have been an issue as total invoice value would, given the passage of time, been pretty close to the cash actually received. As this does not appear to have been a factor that HMRC took into account, the Tribunal set aside HMRC's decision and directed that Apex Vehicle Management Limited should be entitled, within one month of the release of this decision, or such longer period as both parties agree, to submit to HMRC such further evidence regarding its taxable supplies and its financial position as it thinks appropriate. After that, HMRC could make a new decision about the taxpayer's request for retrospective withdrawal from the scheme.

*Apex Vehicle Management Limited v HMRC (TC06911)*

### **R&C Brief 1/2019: Personal contract purchases (Lecture B1126 – 25.43 minutes)**

Previously HMRC regarded supplies made under such contracts as supplies of goods and a separate supply of credit. Following the CJEU's decision in Mercedes Benz Financial Services, HMRC has now revised its view of supplies involving personal contract purchases,

Businesses must adopt the correct treatment for all new contracts after 1 June 2019.

#### *Decision in Mercedes Benz Financial Services*

The CJEU concluded that a judgement must be made by the supplier at the outset of the contract as to what the customer, acting as a 'rational economic actor', would do when entitled to exercise a purchase option. If the customer could profitably sell the asset for more than the cost of the final optional payment, then if they act rationally it can be expected that they will buy the asset.

However if the optional payment is expected to be the approximate open market value of the asset at the time the option must be exercised, then the customer may equally choose to purchase the asset, or return it and so it cannot be expected at the outset that they will buy the asset. When considering this choice, additional circumstances that might impact individual decisions to purchase or not, such as access to funds, should not be taken into account.

The rules apply to contracts that provide for the customer to pay a series of lease payments and then make a choice whether to pay a substantive payment to acquire the asset, or to return the asset at the end of a period of hire without making such a final payment.

### *Deciding on the correct treatment*

The correct treatment of PCP and similar contracts depends on the level at which the final optional payment is set:

- if, at the start of the contract, it is set at or above the anticipated market value of the goods at the time the option is to be exercised, the VAT treatment of the contract will follow the MBFS judgment. It is a supply of leasing services from the outset and VAT must be accounted for on the full value of each instalment, there is no advance, or credit, so there is no finance;
- if, at the start of the contract, it is set below the anticipated market value, such that a rational customer would buy the asset when they exercise the option, it is a supply of goods, with a separate supply of finance. VAT is due on the supply of goods in full at the outset of the contract, the finance is exempt from VAT.

HMRC will generally accept that the optional payment is set below the anticipated market value if it is below the value expected based on historical depreciation rates in immediately preceding years for the same or similar assets, such as the same model of car.

Businesses may use another method to establish the anticipated open market value of the asset, providing it produces a credible assessment of future value, given information available at the time the assessment is made.

Businesses must maintain, as part of their business and accounting records, evidence which demonstrates how they have arrived at the figures they have used.

### *Correcting past VAT periods*

The Brief explains the action that taxpayers should take for contracts entered in to before 1 June 2019.

[www.gov.uk/government/publications/revenue-and-customs-brief-1-2019-change-to-the-vat-treatment-of-personal-contract-purchases](http://www.gov.uk/government/publications/revenue-and-customs-brief-1-2019-change-to-the-vat-treatment-of-personal-contract-purchases)

## **Blinds for eco-home**

*Summary – No refund of input tax relating to the supply of electric blinds fitted at an “eco-build” home under the DIY house-builders scheme was allowed as they were not ordinarily incorporated into buildings of this type.*

David Cosham built an eco-home and, among other things, installed electric blinds in the south facing rooms that were programmed to regulate the temperature in these rooms. He submitted a DIY housebuilders scheme refund to claim input tax incurred on these blinds.

HMRC rejected the claim arguing that the VAT incurred on the blinds did not fall within the definition of “building materials” at Note 22 of Group 5 Schedule 8 VATA 1994. Note 22 states that:

“Building materials” in relation to any description of building, means goods of a description ordinarily incorporated by builders in a building of that description, (or its site), but does not include-

(c) electrical or gas appliances, unless the appliance is an appliance which is –

(i) designed to heat space or water (or both) or to provide ventilation, air cooling, air purification, or dust extraction;”

In HMRC’s view the correct comparator building for the purposes of applying the test in Note 22 to Mr Cosham’s property was an ordinary four bed roomed house and that electric blinds of this nature were not an ordinary feature of such a property. Even if it could be argued that the electric blinds were ordinarily incorporated into buildings of that type, HMRC’s second argument was that they were properly to be classified as “electrical appliances” and so excluded.

Mr Cosham appealed arguing that the blinds were ordinarily incorporated into eco-homes and that the definition should cover materials ordinarily installed into these types of buildings rather than be based on a generic type of building. Mr Cosham pointed out that the electric blinds installed in his property were used for temperature control purposes and so fell outside the exclusion at Note 22 for electrical appliances.

#### *Decision*

The First Tier Tribunal referred to Taylor Wimpey as the leading guidance where the Upper Tribunal stated that:

“In our view the proper comparator in the case of any building is (to look at) buildings which most closely accord with the use of the building in question”.

A building can be categorised by reference not just to its size (HMRC’s view) but also by other defining features. The Tribunal’s view was that eco-homes are generally recognised as a distinct category of building as they are built with specific materials/ features in order to be used for a specific purpose, and therefore they could be treated as a distinct type or description of building for this purpose.

However, on the basis of the evidence provided, the Tribunal could not accept that electric blinds are ordinarily installed in eco-build houses so Mr Cosham’s appeal failed. Thus, there was no need for the Tribunal to consider whether the blinds were electronic appliances for the purposes of the legislation.

*David Cosham v HMRC (TC06985)*

## Designed for use by a handicapped person?

*Summary – The Tribunal found that devices designed for handicapped people but marketed to a wider audience fell within the scope of VAT 1994 Sch 8 Group 12 item 2(g).*

Actegy Limited manufactures and sells electrical muscle simulation devices marketing that the devices:

- Reduce 'aches and pains in the legs and feet; reduce swollen feet and ankles; alleviate cramp; strengthen leg muscles; actively improve circulation';
- Can be used by people suffering from 'diabetes, osteoarthritis, poor mobility, muscular weakness, post-surgery recovery etc.'

Actegy Limited had treated certain products marketed and sold to individuals suffering from chronic illness/disability as zero rated claiming that they fell within Group 12 Schedule 8 VATA 1994 (supplies to handicapped persons).

Schedule 8, Group 12, Item 2(g) includes:

“The supply to a disabled person for domestic or his personal use, or to a charity for making available to disabled persons by sale or otherwise, for domestic or their personal use, of: ... (g) equipment and appliances not included in paragraph (a) to (f) above designed solely for use by a disabled person.”

HMRC disagreed and issued assessments against Actegy Limited for £122,543 in respect of the Medic and £53,246 in respect of the devices.

The taxpayer appealed.

### *Decision*

It was agreed that the devices were for personal use and that they were used by disabled persons and so the issue was whether they were 'designed solely for use by a disabled person'.

The First Tier Tribunal noted that, although the packaging marketed the devices for wider use, the company's technical files stated that the devices were designed for people suffering from diabetes, peripheral arterial disease, chronic venous insufficiency, and osteoarthritis as well as the alleviation of post-surgery pain and, leg vein health in general. They stated that although the ultimate use and marketing may indicate the intention of the designers, the fact that the devices may be used by a wider population does not exclude the devices from being zero rated under item 2(g).

The Tribunal considered that the Technical Files and clinical research (concerning only patients with the identified conditions) represented the primary source of objective evidence of the design intention. The Tribunal concluded that the design focus was on the symptoms of sufferers of the identified chronic conditions even though those symptoms also arise as a consequence of other causes.

Case law is clear that marketing material should be taken into account, and in cases where there is no other evidence will determine the final decision. However, in this case, technical documents clearly set out that the devices were designed for handicapped people. Having established this fact, the marketing to a wider audience was of little relevance.

The appeal was allowed.

*Actegy Limited v HMRC (TC07005)*

## **RORO Transitional Simplified Procedures (Lecture B1126 – 25.43 minutes)**

In the event that the UK leaves the EU without a deal, many UK businesses will need to apply the same procedures to EU trade that apply when trading with the rest of the world. Under such import processes, goods are not released from customs control until you make a full import declaration and pay the duty you owe in full.

However, HMRC has put in place “transitional simplified procedures” to make it easier to import goods from the EU using roll on roll off locations like Dover or the Channel Tunnel by deferring:

- making a full declaration; and
- paying customs duty until after the goods arrive in the UK and then paying monthly by direct debit, rather than having to pay immediately each time goods clear customs.

These procedures can only be used for RORO imports from the EU; imports through other ports or airports will be subject to full customs declarations.

### *Registering*

An agent cannot register for transitional simplified procedures on the importers behalf but once registered, an agent will be able to submit customs declarations on their behalf.

To be able to register the importer must:

- have an EORI number
- be established in the UK, as:
  - a UK resident sole trader
  - a company or partnership with a registered office in the UK
  - a company or partnership with a permanent place of business in the UK where they carry out their business activities
- be importing goods from the EU into the UK (including goods travelling through the EU from the rest of the world providing they’ve cleared EU customs formalities).

Registration will not be allowed where:

- The only goods imported are coming directly from outside the EU;
- the importer is using a customs special procedure for their goods;
- HMRC records show that in the past the importer has had overdue tax returns, has not paid tax or duties due or their business is insolvent.

Using on the link below will take you through the registration process

<https://www.tax.service.gov.uk/submissions/new-form/transitional-simplified-procedures/nonagent>

#### *Standard goods procedure*

For most goods, importers will need to make a customs declaration within their commercial records when the goods cross the border. The information should include:

- the date and time the goods arrived in the UK
- a description of the goods and the commodity code and quantity imported
- purchase and (if available) sales invoice numbers
- the customs value
- delivery details
- supplier emails
- serial numbers of any certificates or licences

A supplementary declaration must be submitted by the 4<sup>th</sup> working day of the month following the arrival of the goods into the UK and then HMRC will collect the duty/ taxes due by direct debit on the 15th day of the same month.

#### *Controlled goods procedure*

Importers of alcohol, tobacco or goods requiring an export licence, do not have the option of making a simplified declaration in their commercial records.

To make a simplified declaration for controlled goods, the importer will need to:

- send a simplified frontier declaration before importing the transitional simplified procedures controlled goods into the UK;
- make sure that the goods are accompanied by full supporting documentation, for example the appropriate licence;

As with other imported goods, a supplementary declaration must be submitted by the 4<sup>th</sup> working day of the month following the arrival of the goods into the UK and then HMRC will collect the duty/ taxes due by direct debit on the 15th day of the same month.

### *Reviewing transitional simplified procedures*

If HMRC decide to withdraw these procedures they will give a 12 month notice period, giving business times to sort out what needs doing, whether that be deciding to:

- use a third party (for example freight forwarder) to complete declarations;
- become authorised to use customs freight simplified procedures;
- complete full declarations themselves.

*<https://www.gov.uk/guidance/register-for-simplified-import-procedures-if-the-uk-leaves-the-eu-without-a-deal>*

## **New VAT rules on prepayments (B1129 – 10.41 minutes)**

### *The issue*

There has always been uncertainty in the VAT world about whether a business must still account for output tax on an advance payment for goods or services, where the customer does not get a refund if he does not receive what he has paid for:

- An advance payment for goods or services creates a tax point – so output tax is due at the time the payment is received if it relates to a taxable supply of goods or services.
- If the customer cancels the order, so does not receive any goods or services from the seller, and the order/contract says he is not entitled to a refund, is the business entitled to reduce the output tax it declared when the payment was made i.e. on the basis that the payment then becomes outside the scope of UK VAT?

### *Business Brief 13(2018)*

The above Brief was issued by HMRC on 13 December 2018 and applies from 1 March 2019. In effect, HMRC has cleared the muddy waters on this issue by confirming the following change in its interpretation of the law:

“When a full or part payment is made on account for a taxable supply, a chargeable event occurs and VAT becomes due on the amount paid. If the supply does not take place, the VAT must not be reduced, unless the payment is refunded.”

### *CJEU case law*

The policy change was announced in the 2018 Budget so is not unexpected. And HMRC’s justification for making the change without the need to amend the law is because it is applying the conclusions of two CJEU cases.

1. Air France-KLM (C-250/14) – about air tickets purchased and not used by the buyer
2. Firin ODD (C-107/13) – about input tax on supplies where payment has been made but no taxable transaction has been carried out.

In the Air France-KLM case, the dispute related to VAT of 5.5% that applies to flights within French territory and whether output tax was payable on cancelled bookings. In ruling for the tax authorities, the court confirmed that the relevant issue was “the passenger’s right to benefit from the performance of the transport service regardless of whether the passenger exercises that right.”

#### *Dealing with VAT on advance payments*

Here is a suggested three-stage process

Stage 1 – Does the deposit relate to a taxable supply of goods or services? – an easy example is a tenant who will rent the commercial premises from a landlord who has opted to tax the building in question. Contrast this with a deposit paid to rent a flat, where the rental income is exempt from VAT, so there will obviously be no output tax issue on any deposit paid in advance.

Stage 2 – Is the deposit non-refundable? if the answer at stage 1 is ‘yes’, then the next challenge is to confirm if the deposit paid by the customer is refundable or non-refundable. And this is where care is needed because output tax is only relevant to non-refundable deposits.

#### *Example*

Joe trades as an ice-cream manufacturer and is going to rent premises from Sue, who has opted to tax the property so will charge VAT on the rent to Joe. This is not a problem for Joe because he is VAT registered and can claim input tax. The rental agreement states that Joe must pay a deposit of three months rent plus VAT at the beginning of the agreement, which will be refunded to him when he leaves the premises if he leaves them in the same condition as he found them.

In this situation, no output tax is due on the deposit because the intention is for it to be refunded to the customer (Joe). It does not reflect an advance payment for goods or services. The reference to VAT is not output tax, it is way of calculating the final amount of the deposit paid by Joe e.g. 3 months x £2,000 per month + 20% = value of deposit.

Stage 3 – What is the tax point? – with two ‘yes’ answers to the first two stages, the final challenge is to decide the tax point for VAT purposes i.e. when the deposit or advance payment is included on a VAT return. It will almost certainly be the date that the deposit is paid by the customer. However, it is important to check that this has not been preceded by an advance sales invoice being raised, which would create an earlier tax point, unless the business is on the cash accounting scheme.

#### *Practical example of new policy*

Imagine a customer books a hotel for March 2019 and pays a non-refundable deposit in January 2019 – say £60. The latter date creates a tax point so 1/6 of the payment is declared as output tax on the VAT return that includes January. If he cancels the booking with the hotel before 1 March 2019, the Brief confirms that the hotel can retain the full £60 deposit and reduce its output tax if this has always been its past policy. But if its policy has always been to still pay the output tax, then HMRC says it cannot change its policy (or claim a windfall on past cancellations and no-shows) because it has applied the law correctly.

If the customer cancels the booking on or after 1 March 2019, or just doesn't show up, the new interpretation will apply to the sacrificed deposit i.e. no reduction in output tax is allowed.

#### *End to confusion?*

A few years ago, a case about advance annual gym memberships received by Esporta Ltd [2014]EWCA Civ 155 was heard in three different courts, the issue being whether output tax could be adjusted if a member cancelled his subscription before the end of the year. The VAT at stake was £1.3m and the court ruled in favour of HMRC, confirming that the company had supplied the right of entry to the gym, even though the member did not fully utilise the facility.

The positive outcome with the new rules is that debates and arguments about the VAT status of forfeited advance payments and deposits should be confined to history. If the supplier keeps the money in the event of a cancellation of goods or services, and it is linked to a VATable supply, then output tax cannot be reduced. Is this a rare and welcome victory for tax simplification?

*Contributed by Neil Warren*

## **Reverse charge for construction services (Lecture B1130 – 13.13 minutes)**

### *Background*

The starting point with any transaction is that the supplier charges VAT on a taxable supply of goods or services made in the UK and accounts for output tax on a VAT return – and hopefully pays this output tax to HMRC.

HMRC has identified that certain supplies have been prone to Missing Trader Fraud, where the supplier charges VAT to a customer and disappears. These supplies are often linked to transactions where there is little input tax sacrificed by the fraudulent business i.e. the "stolen VAT" becomes a sales tax rather than a margin tax. HMRC has identified that there has been a big tax loss with businesses involved selling certain construction services.

### *Reverse charge*

With effect from 1 October 2019, the VAT position will change as far as transactions concerning certain supplies of construction services is concerned. From this date, the customer will account for the VAT by doing the reverse charge on his own VAT return. This means that the supplier neither charges VAT to nor collects VAT from his customer. The reverse charge will apply to the following transactions:

- The legislation refers to 'specified services' but these do not apply to services supplied to non-construction businesses, such as a high street retailer having his premises improved or any other end user customer or building owner;
- The reverse charge will also apply to any goods supplied by the builder as part of his work;

- Supplies between landlords and tenants are excluded from the reverse charge as well as supplies involving connected parties. In such cases, the supplier will continue to charge VAT as happens now;
- The reverse charge will be based on the VAT rate applying for the work in question, but only supplies subject to either 5% or 20% VAT i.e. excluding zero-rated sales.

### *Example*

Mike is an electrician, VAT registered as a sole trader. He is doing some work on an office block, invoicing the main contractor Steve for his work, and Steve will then invoice the building owner.

Mike will not charge VAT to Steve because Steve will deal with the VAT on his own return by doing the reverse charge. This will be a 'nil' outcome for Steve because his onward supply to the building owner is taxable (20% VAT) so he gets input tax recovery in Box 4 when he does the reverse charge entry. Steve will charge 20% VAT on his sales invoice to the building owner because his client is not in the construction industry i.e. the normal rules apply.

### *VAT return boxes*

Going back to the previous example, if Mike charged VAT on his supply, let's say for £5,000 + VAT, then the following entries would be made on his VAT return:

Box 1 – output tax - £1,000

Box 6 – outputs - £5,000

Steve's VAT return would be recorded as follows:

Box 4 – input tax - £1,000

Box 7 – inputs - £5,000

The overall figures are unchanged with the reverse charge legislation – all that happens is that the Box 1 entry recorded by Mike will instead be included on Steve's return – so Mike will only record the net value of the sale in Box 6 i.e. £5,000.

### *Other issues*

There is a precedence of certain supplies of goods and services being subject to the reverse charge as an anti-fraud measure, particularly mobile phones and computer chips if the value of the supply exceeds £5,000. A few other points to consider:

Checks should be applied to ensure that building contractor clients being invoiced under the new rules are properly registered for VAT and are bona fide – see VAT Notice 735, section 9.

Sales invoices should include a reference to 'reverse charge' i.e. so that the customer knows he must account for output tax with the appropriate calculation.

The amount of VAT relevant to the calculation should also be shown on the invoice (usually 20% of the net invoice amount or 5% in some cases) but it must be very clear that the supplier is not charging this VAT.

HMRC suggests that if there are any doubts about the credentials of a customer, then a deposit equal to the amount of output tax not being charged should be collected from the customer e.g. if he has applied for but not received his VAT number.

VAT Notice 735, para 9.3.1 gives examples of customer checks that should be considered.

### *Flat rate scheme*

In most cases, the new changes will only affect the cash flow of a business. This could be important if suppliers have used VAT money in the past to temporarily provide working capital to their business e.g. collecting VAT from a customer in, say, early January, but not paying it to HMRC until the March VAT return is paid in early May. But there is a potential impact on net profit for a construction business that uses the flat rate scheme (FRS), and benefits from the lower rate of 9.5% that applies if at least 10% of the turnover of a supplier relates to materials.

### *Example*

Pete the Plumber has annual sales on £140,000 plus VAT so is eligible to use the flat rate scheme (the annual joining threshold is £150,000 excluding VAT). All of his work is for VAT registered construction businesses and standard rated and because his turnover from materials is £18,000 plus VAT (i.e. greater than 10% of total sales), he can adopt the 9.5% FRS rate for 'general building or construction services'. His total input tax on expenses is £5,000, so his VAT payment with normal accounting would be £23,000 – but with the FRS it is only  $£168,000 \times 9.5\% = £15,960$  (gross income X Relevant FRS percentage).

Reverse charge supplies are excluded from the FRS (VAT Notice 735, para 10.8.1), so Pete's VAT returns after 1 October 2019 will be nil returns. It would therefore be sensible for him to withdraw from the FRS in order to claim input tax on his expenses i.e. £5,000 in total. But he will still be £7,040 worse off each year (£23,000 minus £15,960) because he is no longer making a profit with the FRS.

*Contributed by Neil Warren*

## **Making Tax Digital (MTD) exemption (Lecture B1126 – 25.43 minutes)**

Businesses do not need to sign up for MTD or apply for an exemption if either:

- they already exempt from filing VAT Returns online;
- their taxable turnover is below the VAT registration threshold.

In addition, we have known for some time that certain business will be exempt from MTD. HMRC has now published more details about who will be eligible for exemption and the procedures to follow in order to gain an exemption.

### *Religious grounds*

If a business is run entirely by practising members of a religious society or order whose beliefs are incompatible with using electronic communications or keeping electronic records, then exemption should be available.

However, if such a business is already filing VAT returns online or use a computer or smart device for business or personal use, then exemption will not be granted.

#### *Insolvent business*

Where a business is subject to an insolvency procedure exemption will be granted.

#### *Age, disability, remoteness of location or for any other reason*

HMRC will take effort, time and cost into account in its overall assessment of whether it is practical for a business to follow the MTD rules but are clear that time and effort alone will not be enough to gain exemption.

Age alone will not be enough to gain exemption. HMRC will consider how an individual's age and circumstances impact their ability to follow the MTD rules. They will consider how much the individual uses or intends to use a computer, tablet, smartphone or the internet for other purposes and whether it's reasonable for them to learn how to use MTD software.

if the individual is unable to get internet access at home or business premises and it is not reasonable for them to get internet access at another location, then exemption is possible. This will be denied where a third party is supporting the business with accounting and tax related business. However, where such a party stops supporting the business and the business not think that they can follow the MTD rules without their support, they should approach HMRC for an exemption.

#### *Claiming an exemption*

To make a claim for exemption, the business or third party (agent, friend or family member) will need the businesses:

- VAT Registration Number;
- name and principal place of business;
- reason for exemption request;
- details about VAT Returns are currently filed;
- reasons why they would not be able to follow MTD rules for record keeping/ filing.

#### *HMRC's decision*

HMRC will send out a letter stating that either the business is:

- exempt and that VAT returns should continue to be filed as before
- not exempt and that the business can appeal.

While waiting for HMRC's decision or an appeal decision, the business should continue filing VAT Returns as usual in the normal way.