

Personal tax

(Lecture P1106 – 16.09 minutes)

PAYE error

Summary – A self-assessment tax return should not have been used as a means of collecting known amounts of PAYE underpayments.

Michael Griffiths was a lorry driver who had always had his tax collected through PAYE. He had never filed nor been asked to file a self-assessment tax return until 2013/14.

On 31 May 2014 Mr Griffiths was sent a PAYE tax calculation for the tax year 2013/14. The calculation was issued automatically by computer and showed an overpayment of £579.80. On 1 June 2014, HMRC issued a payable order in respect of the “overpayment” which was actually paid to Mr Griffiths on 3 June 2014.

On 2 June 2014, the day before receiving this money, a revised PAYE calculation was sent to Mr Griffiths showing an underpayment of tax of £581.60 so in fact Mr Griffiths had underpaid his tax by 80 pence.

Having contacted HMRC, he was initially told that the underpayment would be collected through a change in his PAYE coding and so he assumed that the matter had been dealt with. Normally, the underpayment would have been “coded out”, but Mr Griffiths’ income at the time was so low that HMRC were unable to do this. Some eight months later, HMRC issued a “voluntary payment letter” which stated that they would issue him with a self-assessment return if he did not pay the £581.60. On phoning HMRC, Mr Griffiths was once again reassured that the money could, and would, be coded out but never was.

Much later, on 28 July 2016 HMRC issued a notice to file a self-assessment tax return.

Mr Griffiths was confused and unsure what to do. A combination of receiving the self-assessment filing notice combined with the subsequent receipt of penalty notices at a time when numerous scams were in the news, he was worried. He instructed an agent, who submitted the outstanding tax return in June 2017 but also appealed to the First Tier Tribunal against the penalty notices arguing that:

- The penalties were not due because the notice to file a tax return was invalid;
- There was a “reasonable excuse” for any failure to submit the return on time.

Decision

The First Tier Tribunal concluded that, as a P800 tax calculation had been issued HMRC was already aware of how much income Mr Griffiths owed. This was not a matter that needed to be established (s8 TMA 1970), and so the notice to file a return was not made for the reason mandated by legislation. The notice was invalid, and so were the related penalties.

Even if this had not been the case, the First Tier Tribunal concluded that Mr Griffiths had a reasonable excuse for the delay in filing his return. They referred to the fact that HMRC should have taken “the experience, knowledge and other attributes of the particular taxpayer” into account, as well as the fact that at the time, seeking help from HMRC would have involved calling the helpline whose performance, according to the National Audit Office, “at the time was abysmal; half of calls to HMRC were not answered”. Taking account of all the circumstances, including the fact that Mr Griffiths believed everything had been sorted out and would be dealt with through PAYE and all of this was happening at a time when scammers pretending to be HMRC were in the news, Mr Griffiths did have a reasonable excuse.

Michael Kenzie Griffiths v HMRC (TC06697)

Late filing of P35

Summary – The taxpayer company did not have a reasonable excuse for the late filing of its P35 for 2010/11.

George Edwards Consulting Ltd had overpaid PAYE of about £5,000 for the three years to 2009/10 and had sought repayment or set off the amount from HMRC.

HMRC was suspicious about why overpayments had been made. It turned out that the company had set up a system of paying a set amount of PAYE each month to HMRC based on one-twelfth of the estimated amount due for the year. Those calculations were consistently over-prudent and, as a result, the company had paid too much PAYE. HMRC agreed to repay the excess on receipt of the P35 for 2010/11.

The company's director refused to submit this saying that it was not worth the expense of asking his accountant to prepare the document. The return was finally submitted on 30 January 2015.

The company appealed against penalties under s98A TMA for late filing of form P35 for 2010/11 arguing that it had a reasonable excuse for not filing the return.

Decision

The First Tier Tribunal said that the obligation to submit form P35 is absolute; it is not dependent on its being commercially advantageous.

The Tribunal noted the irony that, in attempting to save the £400 cost of preparing the P35, the company had landed itself with a penalty of £1,200.

The company's appeal was dismissed.

George Edwards Consulting Ltd v HMRC TC6760
Adapted from case summary in taxation (15 November 2018)

Employee rewards using loans

On 9 November, HMRC published the GAAR advisory panel's opinion on arrangements designed to reward an employee through a third party, enhanced by loans with creditor rights transferred to an employer financed retirement benefit scheme. Unsurprisingly, the panel's conclusion was that the arrangements were not a reasonable course of action in relation to the relevant tax provisions.

The arrangements

The taxpayer was the operations manager, executive director and 50% shareholder of a company.

In August 2014 he resigned from his employment and executive directorship but was appointed as a non-executive director. At the same time he took up an employment contract with an agency, which then provided his services back to the company under a contract for services.

It was reported that a typical month would involve the agency:

- Invoicing the company a net amount of about £10,400 for the taxpayer's work;
- Paying the taxpayer a gross salary equivalent to about £990 (National Minimum Wage) but also making interest free, "discretionary" loans totalling about £7,500 to the taxpayer that were repayable on demand;
- Transferring the creditor rights to those loans to an employer financed retirement benefit scheme set up for the purpose.

The opinion

The GAAR advisory panel concluded that the intended outcome of the arrangements was that the company continued to receive the benefit of the taxpayer's services and the taxpayer continued to have funds made available to him in return for those services. They stated that the new arrangement resulted in:

- The company continuing to claim a corporation tax deduction for the amounts paid for the taxpayer's services;
- A post tax return to the employee of 79% - 82% against a standard employment post tax return of 48% - 56%.

In summing up, the Panel's opinion concluded that the arrangement sought, in an abusive way through a series of contrived steps, to reduce the normal incidence of tax on the taxpayer's continuing reward for services stating that: the:

- 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.

Contractor rewards using loan scheme

On 9 November, HMRC published a second GAAR advisory panel's opinion, on a contractor loan scheme involving the transfer of creditor rights to an employer financed retirement benefit scheme.

Once again, the 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 arrangements in outline

Prior to the arrangements, the taxpayer's services were provided to a third party via his own personal services company.

Following termination of the arrangements he was employed by a third party agency employer company who provided the taxpayer's services to the company for a gross salary of about £8,000 (again equivalent to the national minimum wage), followed by an interest-free loan of around £83,000, repayable on demand, and paid in monthly instalments. Once again the creditor rights in the loans were then transferred to an employer financed retirement benefit scheme (EFRBS) set up for the purpose.

The taxpayer argued that the interest-free loan of £83,000 fell outside the disguised remuneration provisions.

HMRC argued that the taxpayer was liable to income tax and NICs on employment income of around £91,000, rather than only on the national minimum wage element of around £8,000. HMRC also contended the liability owed to the EFRBS by the taxpayer was never intended to be met.

The opinion

The GAAR advisory panel stated that the post tax return to the taxpayer of these arrangements was consistent with the promise in marketing material associated to the scheme of 79% - 82%, against a standard employment post tax return of 48% - 56%.

The panel noted that the taxpayer and the marketed scheme promoter had adopted a series of 'artificially contrived steps to gain a tax advantage concluding that the:

- 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-contractor-rewards-using-loans

Compensation for the mis-selling of a financial derivative

Summary - Redress payments made to compensate for the mis-selling of financial products were found to be revenue in nature rather than capital items and so taxable as income

The Appellants were seven brothers who ran a property letting business. Three of the brothers held the legal titles to the properties but it was common ground that they held those properties in equal shares for all of the brothers.

In 2001 the brothers approached their bank, National Westminster Bank plc., to restructure an existing loan in order to raise capital to expand the property business. At the time, the loan was self-financing and rental values were rising. The bank made it a condition of restructuring the loan that they enter into a swap agreement. The Gadhavi brothers had no understanding of interest rate hedging products and were provided with little information about how they worked or the risks involved. They made payments under the swaps for several years and those payments were deducted as revenue expenses of the property business.

Following the financial crash, interest rates fell dramatically, but the brothers were locked into a high fixed rate under the swaps. Ultimately, the costs of the swaps resulted in the failure of the business. The properties had to be sold and by the end of the 2011/12 tax year the business had ceased.

In 2012 the FCA identified failings in the way nine banks, including NatWest, had sold swaps and other interest rate hedging products to clients. The banks agreed to carry out reviews of their sales of such products to customers subject to the supervision of independent reviewers appointed under the Financial Services and Markets Act 2000. The reviews resulted in the banks agreeing to pay redress sums to large numbers of unsophisticated customers including the brothers in this case.

The issue to be decided was how these payments should be treated for tax:

- HMRC treated the redress payments and associated interest as revenue and so subject to income tax;
- The brothers argued that the payments were capital in nature and not taxable.

Decision

The First Tier Tribunal said that the aim of redress was to put the customer in the position they would have been had they not used the product. The Tribunal said that the swaps related to loans taken out to expand their property letting business and fell within s264 ITTOIA 2005 with the sums payable being deducted as a revenue expense for tax purposes. Consequently, the basic redress payment must reverse these deductions and so be taxable as a revenue receipt.

In addition, the interest element of the payment was held to be a supplement of the basic sum, not a separate payment that was part of an overall package. They were liable to income tax as a post-cessation receipt, but subject to a credit for the basic rate tax deducted at source on the interest element.

The appeal was dismissed.

Gadhavi and others v HMRC (TC06762)

Transfer of s32 buyout pension policy

Summary – A transfer from a s32 buyout pension policy to a personal pension policy, with a statement of wishes identifying two sons as beneficiaries, was a transfer of value for IHT.

Mrs Staveley and her husband built up a company of which she was a director. They divorced and, as part of her settlement in 2000, she gave up her role in the company and was granted her pension in the form of a s32 buyout policy (S32 FA 1981). This allowed her to invest the fund as she chose but any surplus on her death would be returned to the company.

In October 2006, two months before her death in December, aged 56, Mrs Staveley transferred the s32 policy to a personal pension policy. If Mrs Staveley's pension had remained in the original policy, on her death, a lump sum would have been payable to her estate and chargeable to IHT. Under the Personal Pension Policy, Mrs Staveley nominated her two sons as her beneficiaries in relation to the death benefit. Consequently, if the purchase exemption applied, her sons would receive the death benefit free of IHT. She did not draw any benefit from the new policy.

HMRC looked to charge both events to tax arguing that:

- the transfer to the new personal pension plan was a transfer of value (s3(1) IHTA 1984);
- failing to withdraw benefits was a further transfer as the sons' estates had increased in value (s3(3) IHTA 1984)

The personal representatives' appeals had been successful at the First-tier Tribunal and Upper Tribunal, so HMRC took the case to the Court of Appeal.

The main issue was whether Mrs Staveley had made the transfer 'with the intention of giving her sons a gratuitous benefit'.

Decision

The Court of Appeal found that the rights that the sons had acquired under the PPP were different from those they had as beneficiaries under the will; their rights under the will were only indirect and might be reduced by other liabilities of the estate or other gifts. More generally, the court considered that it could not have been Parliament's intention to allow s10(1) to apply in all circumstances where the donor has, in some way, donated the same asset previously. The court added that the exclusion of 'any' gratuitous benefit was widely drafted and suggested that s 10(1) was intended to be narrowly construed.

The court also found that Mrs Staveley's omission to draw benefits after the transfer had been both an associated operation within the meaning of s268 IHTA 1984 (since 'operation' 'included an omission') and one intended to confer a gratuitous benefit. The judge said the tribunal had been wrong to decide there had been no intent linking the omission to take pension benefits and the transfer to the personal pension. Both transactions formed part of the same disposition. Therefore, there was a conferral of a benefit and a newly conferred right because the beneficiaries acquired the new rights under the personal pension scheme rules. HMRC's appeal was allowed.

*CRC v Parry and others, Court of Appeal, 16 October 2018
Adapted from case summary in Taxation (1 November 2018)*

Business relief for livery stables

Summary – The Upper Tribunal agreed with the First Tier Tribunal that the livery business ran on 30 acres of land qualified for 100% business relief.

As Robert Jamieson reminded us last month, Mrs Vigne ran a livery stable on some 30 acres of land taking in horses in the spring, summer and early autumn but then closed for the winter. On death, the business was valued on a net asset basis including her valuable land. She claimed 100% business relief which HMRC denied, arguing that her business was one of 'wholly or mainly of making or holding investments' meaning that relief was not available.

The First Tier Tribunal had concluded that no properly informed observer could have concluded that her livery business was wholly or mainly a business of holding investments. They concluded that Mrs Vigne had a business, she was providing services relating to that business and 100% business relief was allowed.

HMRC appealed to the Upper Tribunal. In HMRC's view, the business was an actively managed letting business and that the additional services were not sufficient for the business to qualify for 100% business relief.

Decision

The Upper Tribunal found that the First Tier Tribunal had explicitly addressed the issue of whether the livery activity was one of wholly or mainly a business of holding investments. On the basis of the evidence before it, the First Tier Tribunal were entitled to reach their conclusion that 100% business relief applied to the deceased's livery business as it provided 'significantly more than the mere right to occupy a particular parcel of land'.

HMRC v The personal representatives of the estate of M. Vigne [2018] UKUT 357

Gift with reservation of benefit

Summary - The grant of a sub-lease with covenants reflecting those included in the head lease was a gift with reservation of benefit.

The issue was whether a reversionary long sub-lease of a valuable London residential property, granted on favourable terms by Lady Hood to her three sons in 1997, was property subject to a reservation when she died in 2008, four years before the sub-lease would have fallen into her possession. If the sub-lease was property subject to a reservation, it formed part of her estate chargeable to IHT on her death. If the sub-lease was not property subject to a reservation in her estate, it escaped IHT on her death, because it was not deemed by s102 to be part of her estate and the original grant of the sub-lease was a potentially exempt transfer (PET) which she had survived by more than seven years, and which consequently became an exempt transfer.

The case turned on whether the sons' enjoyment of the sub-lease was 'to the exclusion, or virtually to the entire exclusion ... of any benefit [to the donor] by contract or otherwise'. HMRC contended that this test was not satisfied, because the sons entered into a direct covenant with their mother in the sub-lease to observe and perform the provisions in the head lease as if they had been repeated in full (subject to any necessary modifications) in the sub-lease.

The executors argued, however, that the donated property was the sons' sub-leasehold, which from the outset had the sub-tenants' covenants in the sub-lease imprinted on it. They said that had the sons assigned their sub-leasehold estate, the assignee would have acquired it subject to their covenants.

Decision

Agreeing with the executors, the court observed that the gift made by Lady Hood was a gift of an interest in land subject to, and with the benefit of, the obligations that the parties agreed to undertake in the sub-lease.

However, the court did not agree that this identification of the subject matter of the gift excluded the operation of s102. It noted that in her capacity as the intermediate lessor of the property, Lady Hood had the benefit of the positive covenants given by her sons.

Although those benefits were future ones (they would only come into force when the sub-lease fell into possession in March 2012), they would then endure for the benefit of Lady Hood (or her estate after her death) until 2076 or the prior termination of either the head lease or the sub-lease. 'This was undoubtedly a benefit to Lady Hood of real, and more than minimal, value; and, crucially, it had no prior existence before the grant of the sub-lease.'

The court added that the fact that the benefit to the donor was inseparable from the gift itself only went to show the closeness of the connection between the gift and the benefit, as in *Buzzoni* [2014] 1 WLR 3040. It also noted that both *Nichols* [1975] 1 WLR 534 and *Ingram* [2010] 1 AC 293 were authorities for the proposition that if the gift of a leasehold interest is accompanied by positive covenants which confer additional benefits on the donor, there is a reservation of benefit within s 102(1) (b).

Viscount Hood (executor of the estate of Lady Hood) v HMRC [2018] EWCA Civ 2405
Adapted from case summary in Tax Journal (9 November 2018)