

Personal tax update (Lecture P1346 – 18.07 minutes)

Employee, worker or self-employed

Summary – Using the Construction Industry Scheme was only one of the factors to be considered in determining the individual's correct status. Looking at the findings as a whole, the only proper conclusion was that the individual was an employee.

From 2010, Lee Richard worked as a skilled carpenter on a self-employed basis, receiving net payments under the CIS from the company that he worked for.

In 2018, the company he worked for reviewed its arrangements and sought to engage him under an employment contract. For most of the time that followed, he was on sick leave and later resigned.

Lee Richard appealed to an employment tribunal, claiming that he had been an employee throughout the period of engagement; not just from 2018.

The employment tribunal dismissed the appeal stating that both parties had agreed to pay him on a self-employed basis through the CIS.

Lee Richard appealed to the Employment Appeal Tribunal.

Decision

The appeal tribunal found that the employment tribunal had erred in finding, in a working relationship which had numerous indicators of employment status and only one in favour of self-employment, that the latter should determine the issue.

The Tribunal found that Lee Richard was an employee and remitted the appeal to the Employment Tribunal with an instruction that it had to proceed on that basis.

Justine Riccomini, head of tax (employment and devolved taxes) at ICAS, stated:

'Having read through both case transcripts, it occurs to me that the original employment tribunal (ET) judgment focused on the fact the appellant was registered for CIS purposes rather than the underlying facts of the working arrangements. This appears to have been a distraction. The facts described in the ET decision state that the appellant was a skilled carpenter who worked five days a week on an hourly pay rate for the same engager over the best part of a decade, with no other clients to his name, and that the arrangements were, in everything but name, providing for a contract of service

'To all intents and purposes, the appellant appears to have fallen within the definition of a "labour-only" subcontractor at Construction Industry Scheme Reform Manual CISR13030. Had this factor been considered by the ET, a different conclusion may have been reached.

'Usually, for employer's liability insurance purposes, labour-only subcontractors are treated as employees, and HMRC generally expects that labour-only subcontractors should be paid under deduction of PAYE through the payroll rather than being paid under the CIS scheme (see CIS340, section 1.8 – tinyurl.com/hmrccis340), where HMRC says:

"For a contract to be within the [CIS] scheme, it must not be 'a contract of employment'. This means that the scheme applies to workers who are self-employed under the terms of the contract, and not employees subject to PAYE.

"Employment status depends on general law and it's for the contractor to decide on the individual's employment status when the subcontractor is first engaged. The fact that the subcontractor has worked in a self-employed capacity before is irrelevant in deciding on their employment status — it's the terms of the particular engagement that matter."

This case illustrates how employment legislation and tax legislation are sometimes misaligned and decisions can be skewed as a result. Had this case been heard at the tax tribunal, it is likely the CIS guidance would have been considered.

Lee Richard v Waterfield Homes Ltd and Unity Build & Repairs Ltd, EAT

Contributions to EBT not repayable during liquidation

Summary - Contributions made by a company to an EBT under an avoidance scheme had been found to be taxable employment income. The director who benefited from the payments made was not liable to repay these sums after the company went into liquidation.

The case was brought by Asertis Limited on behalf of the liquidator against Dale Heathcote, the sole director of Servico Build Tec Limited.

Servico Build Tec Limited had entered an employee benefit trust scheme, with sums totalling £520,000 paid to the trust and used to buy gold. This was provided to the beneficiary, who in this case was the company's sole director. He could keep or sell the asset as he so wished.

The Scheme was designed to allow Dale Heathcote to obtain rewards from the company without tax becoming payable either by the company or by him. However, HMRC enquired into the company's tax returns, concluding that the EBT scheme did not work and that the sums represented taxable employment income.

Later, following the loss of a big contract with Next plc and the announcement of the 2019 Loan Charge, Servico Build Tec Limited went into voluntary liquidation. Asertis Limited claimed that the sums paid to the EBT were repayable by Dale Heathcote as the rewards:

- were neither authorised nor justifiable as remuneration to Mr Heathcote for his services as director and had no other proper basis and, thus, made in breach of his duties to the Company as its director; and/or
- represented transactions at an undervalue defrauding creditors under s.423 of the Insolvency Act 1986; and/or
- were made in breach of what is commonly referred to as the insolvency or creditors' interests duty.

Decision

The High Court found in favour of Dale Heathcote concluding that the payments made represented Dale Heathcote's year-end bonus and were linked to the company's profitability. Dale Heathcote and the company's accountant had entered into the transactions on the basis that if the EBT was found not to be tax effective, there would be sufficient funds available, either from the company's profits or Dale Heathcote's own assets, to be able to settle any PAYE or NICs that fell due.

Although the scheme was found to be ineffective for tax, this did not render them recoverable payments. The rewards were always intended to be a form of bonus for services rendered. This fact was included in the company's board minutes. There was no evidence that Dale Heathcote's rewards were excessive or unreasonable as director's remuneration or that they were disguised gifts of capital rather than genuine awards of remuneration.

Asertis Ltd v Mr Dale Heathcote and Servico Contract Upholstery Limited [2022] EWHC 2498

OTS property income report

The OTS has published a report on the Income Tax rules for residential property income. The key findings are summarised below.

Furnished holiday lettings (FHL)

Despite the tax benefits offered, the report stated that the FHL regime is not widely used but adds complexity to the tax rules.

If abolished, the OTS acknowledged that this might place pressure on the distinction between whether let property is a trade or a business, with taxpayers seeking the benefits of the trading rules. The OTS recommended that it would be appropriate to introduce a statutory 'brightline' test to define when a property trading business was being carried on.

If the regime was retained, the OTS recommends the government consider restricting the relief to commercial lets and changing the rules to cover either just UK or worldwide properties.

Deductibility of repairs, replacements, and improvements

This is a confusing area for taxpayers who find it difficult to decide if costs are immediately deductible as repairs and replacements or, are they disallowable capital improvements.

The OTS recommends that either:

- guidance in this area should be enhanced to include clear examples of common situations; or
- income tax relief should be available on all property costs, except for where the work is part of the capital cost of the building, such as the initial fit-out of properties bought in a dilapidated state or structural work such as extensions to the property. This would make it simpler to administer and support the policy objective of improving the standards of rental property.

Jointly owned property

To bring things in line with all unmarried co-owners, the OTS report recommended that the automatic 50:50 taxation split for spouses and civil partners should be changed so that the split reflects the underlying ownership.

The report also suggested that the government may also wish to consider removing the ability for joint owners to decide on a split other than this ownership.

Making Tax Digital for Income Tax

The OTS report identified several potential areas for improvement, including:

1. allowing joint owners to file one return between them;
2. increasing the minimum threshold for reporting; and
3. delaying the introduction until the system has been improved and tested.

Diversified agricultural-based businesses

in order to make their business viable, the report stated that around 66% of agricultural businesses are diversified and their income may well include property-related income.

The report explains the challenges faced by such businesses in the way the tax system disaggregates streams of income for reporting, availability of reliefs and losses. The review recommends that a 'rural business unit' should be established for tax, to simplify obligations on diversified agricultural-based businesses.

Non-UK residents

Unless a non-UK resident landlord registers to file and pay with HMRC, the Non-Resident Landlord Scheme requires the deduction of tax at source from rents paid to them. This obligation falls on letting agents or, if there are none, on tenants and it is not widely understood. The report highlighted the low compliance with the tax withholding regime and recommended that the government consider reviewing this policy.

If tenant withholding is retained, the government could consider raising the threshold, making the withholding obligation on tenants clearer in guidance and finding ways to raise awareness, and clarifying the process to rectify matters if tenants initially do not withhold.

<https://www.gov.uk/government/publications/ots-review-of-residential-property-income>

Public right of way and mixed use

Summary – A public footpath maintained by the owners, which ran across the rear of their property, did not make a property mixed use and so the lower non-residential SDLT rates did not apply.

On 28 August 2020, James and Charlotte Averdieck jointly purchased a property for £2,999,000 and shortly after filed a stamp duty land tax return on the basis that the property was residential and that £258,630 of SDLT was payable.

Just over three months later, their agent wrote to HMRC stating that the property had been misclassified and should have been classed as “mixed use” arguing:

“The public footpath which runs across the rear of the property is classed as a public highway by the local highway agency and our client is responsible for keeping the footpath safe for all users who pass through their land. The public footpath restricts the use of the land acquired by our client and as such, the public footpath does not contribute to the reasonable enjoyment of the dwelling.”

Further, the couple argued that the land that the path was on was used for a separate commercial purpose, as it granted access to a farm, disturbing their use as a residential property.

The couple amended the return and sought repayment of £119,180 with interest.

In August 2021 HMRC opened an enquiry and later issued closure notices on the basis that the transaction was not mixed use.

Decision

The First Tier Tribunal confirmed that the right of way was used by the couple to access the property, as well as by other property owners and a farm further down the lane.

The use of the path by a farm did not make it a place where business was conducted. No one conducted their business on the lane.

Further, the fact that they had statutory obligations to maintain the path did not change the fact it was used as part of the residential property.

The appeal was dismissed.

James and Charlotte Averdieck v HMRC (TC08623)

Human, not computer error

Summary – An error by the person submitting a CT return for the wrong year was not a reasonable excuse for the late filing of a return.

On 21 October 2018 HMRC issued a notice to file a return for the period to 30 September 2018, with a filing date of 30 September 2019.

On 6 November 2019, the company filed a return for the period to September 2019, not September 2018.

Later, having established that the company’s 2018 return had not been submitted, it submitted the missing return on 13 January 2021, electronically. This was 836 days late, resulting in a penalty of £4,343.70,

The company challenged the penalty stating:

“There seems to be some sort of clerical issue as the return for the year ended 30.9.18 was originally submitted on 6.11.2019.”

HMRC replied that it did not consider that the company had a reasonable excuse for the late filing of the CT return for the 2018 return because the submission receipt dated November 2019 properly related to the period ended 30 September 2019.

The case moved to the First Tier Tribunal.

Decision

The Tribunal found that the issue arose due to human error. The likely explanation was that the person who submitted the return had clicked a wrong button and filed the wrong year's documents. Unfortunately, this was not checked until some 11 months later.

The company was "aware of the risks of filing the wrong documents. It should have checked that the correct documents had been sent, and it should have done so far more timeously than it did so." Such a human error did not provide a reasonable excuse.

The company's appeal was dismissed, and the penalty assessment upheld.

T. PA Accountancy Services Limited v HMRC (TC08601)