

Tolley® CPD

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Personal tax

Image rights payments (Lecture P1141 – 13.28 minutes)

Summary – The sums payable under the Playing Contract and Image Rights Agreement were an overall package required by the player and were a reward for his services as a footballer and formed part of his earnings.

Hull City AFC (Tigers) Limited runs a football club that was promoted to the Premier League for the 2008-09 season.

Following his release by Manchester City, on 7 July 2008 the club signed Mr Geovanni Gomez (known as Geovanni) on a 2-year Playing Contract. On 7 November 2008, well into the season, a contract was signed in respect of Geovanni's overseas image rights between the club and Joniere Limited, a company registered in the British Virgin Islands. In September 2009 Geovanni's contract was extended by a year, and potentially a further year; the Image Rights Agreement was similarly extended. Geovanni left the club when they were relegated in 2010 with both his playing contract and the Image Rights Agreement terminated at that time.

Between December 2008 and July 2010 the club paid Joniere a total of £440,800, under the Image Rights Agreement. HMRC argued that the club should have accounted for PAYE and NIC on this amount as it was taxable as part of Geovanni's earnings, rather than his image rights under the separate image rights agreement.

Decision

The First Tier Tribunal stated that real issue was whether the payments made were emoluments as a reward for Geovanni's past, present or future services as a football player or whether they were consideration for the licensing of Geovanni's image rights. It was important to consider the substance of the payment rather than merely its form.

The Tribunal were satisfied from expert evidence that in 2008 Premier League clubs outside the top 6 did not generally have the skills to maximise commercial opportunities involving the exploitation of image rights. Although Geovanni came from Manchester City, at that time they were a mid – league team where he played for one season, mainly coming on as a substitute. He did not have an image rights agreement while there.

The Tribunal found that there was no reliable evidence as to how the Hull City arrived at the annual image rights payment. Moreover, the club did not have the resources to exploit Geovanni's overseas image rights or any real interest in commercially doing so. The Tribunal was not satisfied that Geovanni's overseas image rights had any commercial value.

The Tribunal concluded that, viewed realistically, the sums payable by the Club to Joniere were actually paid to secure Geovanni's services as a footballer and not to obtain the right to commercially exploit his overseas image.

The appeal was dismissed.

*Hull City AFC (Tigers) Limited v HMRC (TC07074)***Company cars - advisory fuel rates from 1 June 2019**

HMRC has published revised advisory fuel rates for company cars, applying from 1 June 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	12 pence	8 pence
1401cc to 2000cc	15 pence	9 pence
Over 2000cc	22 pence	14 pence

Engine size	Diesel
1600cc or less	10 pence
1601cc to 2000cc	12 pence
Over 2000cc	14 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

Insurance bond and personal allowance (Lecture P1141 – 13.28 minutes)

Summary – The gain on surrender of a life insurance bond was taxable as income but eligible for top slicing relief, and the taxpayer was entitled to claim a deduction for their personal allowance.

Mrs Silver had purchased a life insurance bond in October 1993 for £55,000. Approximately £2,200 was withdrawn from the bond annually over the next 21 years and she surrendered the bond in May 2015 for just under £120,000. The Chargeable Gain Certificate issued by the insurance company showed a gain close to £110,000 calculated as the bond's surrender value plus amounts withdrawn minus purchase price.

In 2015/16, Mrs Silver had other income that amounted to £31,101. HMRC argued that because her adjusted net income was £141,822 she was not entitled to any personal allowance.

Mrs Silver argued that she was entitled to top slicing relief of about £22,000 under s535 ITTOIA 2005. HMRC argued that their manual was quite clear that top slicing relief could not be used where the taxpayer was not entitled to a personal allowance.

Decision

The First Tier Tribunal agreed with HMRC that the chargeable event gain was income making her total income £141,822 for 2015/16.

Under normal circumstance her personal allowance would be deductible from this amount. However, under s35 ITA 2007, where an individual's adjusted net income exceeds £100,000, the allowance is reduced by one-half of the excess. Having taken this adjustment into account, the Tribunal agreed with HMRC, that she had no personal allowance left.

But was this affected by top slicing relief?

The legislation requires a hypothetical tax calculation so that rather than taxing the full gain in the year of surrender, a hypothetical annual equivalent is calculated. In this case the amount was £5,272.43 ($£110,721 \div 21$). Hence Mrs Silver's hypothetical income under this calculation was £31,101 plus £5,272.43 making a total income of £36,373 for each year.

The Tribunal went on to say that the legislation:

'Consistently applying the assumption that Mrs Silver's income was only £36,373.43 meant that she was (in this hypothetical scenario) entitled to a personal allowance in this calculation.'

The Tribunal made it clear that parliament's intention with top slicing relief was:

'to allow a person who had taken income over a number of years to have relief when provisions taxed them to the entire income in a single year. The relief was intended to make the tax liability approximate to what it would have been had the income been taxed in the year it was actually received. So when carrying out the hypothetical tax calculation it made every kind of sense that the taxpayer should be treated as entitled to the reliefs that that hypothetical income would have entitled her to.'

The Tribunal disagreed with HMRC, saying that their approach was inconsistent with parliament's intentions. Their approach would result in someone who was a basic rate taxpayer in the year of surrender, and who would not have had any higher rate tax to pay on the withdrawals from the bond had it been taxable year by year, having to pay higher rate tax on the entire gain. As the Tribunal stated, top slicing relief would be denied to those it was intended to help.'

Marina Silver v HMRC (TC7103)

CIOT response to private sector off-payrolling (Lecture P1141 – 13.28 minutes)

The CIOT has set out its view in response to HMRC's consultation on how the off-payroll working rules will apply from 6 April 2020.

Remember, the off-payroll working rules apply to those deemed to be working like employees, typically through their own company. They do not apply to the self-employed. From 6 April 2020, the plan is to extend these rules to all sectors, excluding small private businesses.

CEST needs improving

The CEST tool was launched when the off-payroll working rules were introduced for the public sector in April 2017 to help businesses and workers decide the employment status of their engagement.

The CIOT are concerned that this tool is not good enough. It has previously raised concerns that CEST does not factor in all the criteria established by case law as needing to be considered before reaching a decision on whether IR35 applies. Consequently, CEST does not always give an accurate employment status determination.

Colin Ben-Nathan, Chair of CIOT's Employment Taxes Sub-committee, said:

“If businesses are to make the correct decisions on whether the off-payroll rules apply then we think that the existing CEST will need to be significantly improved. And we also think that the improved version will need to be ready by October 2019 at the latest so that new and existing contracts can be reviewed by April 2020.

“Until CEST takes proper account of mutuality of obligation, multiple engagements, contractual benefits - such as holiday pay, maternity/paternity pay - and whether someone is in business on their own account, it is unlikely it will be able to reach the right decision on status. And this is important because otherwise the lack of confidence in CEST will increase disputes between businesses and contractors and so lead to significant time and effort having to be expended by businesses, contractors, HMRC and the courts in trying to resolve them.”

Exclusion for small businesses

The CIOT welcome the Government's decision to exclude small private sector entities from rules, and suggest the Government consider extending the exclusion to small public sector businesses to ensure a level-playing field.

The CIOT also questions how employee numbers will be calculated in the small entity test. A test based on a simple employee number count (even if averaged across the year) may discriminate against businesses with predominantly part-time employees; this could discourage businesses from taking on part-time employees in order to retain small business status.

www.tax.org.uk/media-centre/press-releases/press-release-improvements-needed-hmrc's-assessment-tool-payroll-working

Capital Taxes

Principal private residence ancillary reliefs (Lecture P1142 – 28.02 minutes)

The ancillary reliefs

On 1 April 2019, HMRC published a 23-page consultation document entitled 'Private Residence Relief: Changes To The Ancillary Reliefs'. This explains that the core private residence relief, which the Government are committed to retaining, is supplemented by various ancillary absence reliefs aimed at dealing with other situations where imposing a CGT charge would lead to what HMRC call 'undesired outcomes'.

The paper lists four ancillary reliefs which go under the headings of:

1. job-related accommodation;
2. final period exemption;
3. work-related and other absences; and
4. lettings relief.

The job-related accommodation relief (see S222(8) TCGA 1992) applies where an individual owns a property which they intend to occupy as their only or main residence, but for work reasons they are currently required to live elsewhere.

Where a property is, or has been, occupied as an individual's only or main residence, the final 18 months of their period of ownership always qualifies for private residence relief, regardless of the property's use during that period (see S223(1) TCGA 1992). This final period exemption is extended to 36 months by virtue of S225E TCGA 1992 for a property owner:

- who is in, or is moving into, a care home as a 'long-term resident'; or
- who is disabled.

Certain periods of absence can count as residential occupation where the property is occupied as an individual's only or main residence before and after the absence (see S223(3) TCGA 1992). These comprise:

1. absences for whatever reason, totalling no more than 36 months in all;
2. absences during which the individual (or their spouse or civil partner) is in employment and all their duties are carried on outside the UK;

3. absences totalling no more than 48 months in all when either:
- the situation of their place of work prevents someone (this includes a spouse or civil partner) from living at home; or
 - an employer requires an individual (this also includes a spouse or civil partner) to live away from home for the effective performance of their duties.

The relief given for absences under (2) and (3) above is still available even if the individual cannot return to their home afterwards because the nature of their work requires them to continue to work away.

Where an individual lets out all or part of their main residence (or former main residence), a special lettings relief is available under S223(4) TCGA 1992. This relief, which is set against the gain on the disposal of the property, is the lowest of three alternative figures:

- the amount of the individual's private residence relief, i.e.. his exempt gain; or
- £40,000; or
- the amount of the individual's chargeable gain in relation to the letting.

The effect of private residence relief and the ancillary reliefs using the existing legislation is shown in Illustration 1 below.

Illustration 1

Jasper purchased a flat with a 99-year lease on 1 March 2000 for £250,000 and occupied it as his main residence until 1 March 2006 when he departed on the QE2's final two-year round-the-world cruise. During that time, Jasper's flat was left empty. He reoccupied the property on 1 March 2008.

Jasper subsequently bought a new property which he used as his main residence from 1 March 2015 onwards (he made the requisite nomination under S222(5) TCGA 1992).

Jasper rented out his old flat for five years until 1 March 2020 when he sold the long lease for £850,000.

Jasper had owned the flat which he sold on 1 March 2020 for a period of 20 years (240 months). During that time, he occupied the flat as his main residence for 13 years (156 months), was absent for two years (24 months) and rented it out for five years (60 months).

Jasper's gain is:

	£
Sale proceeds	850,000
Less: Cost	<u>250,000</u>
	<u>£600,000</u>

$156/240 \times \text{£}600,000 = \text{£}390,000$ is eligible for private residence relief and so this part of the gain is not liable to CGT.

$24/240 \times \text{£}600,000 = \text{£}60,000$ qualifies for absence relief and so this part of the gain is not liable to CGT.

Note that Jasper cannot claim an additional 12 months' worth of relief under S223(3)(a) TCGA 1992 since he never reoccupied the property after he moved into his new residence on 1 March 2015.

$18/240 \times \text{£}600,000 = \text{£}45,000$ qualifies for the final period exemption and so this part of the gain is not liable to CGT.

Jasper's tax position at this stage is:

	£	£
Gain		600,000
Less: Private residence relief	390,000	
Absence relief	60,000	
Final period exemption	<u>45,000</u>	
		<u>495,000</u>
		<u>£105,000</u>

His lettings relief is set against this figure and is the lowest of:

- (i) £495,000; or
- (ii) £40,000; or
- (iii) £105,000 (this is Jasper's chargeable gain which is attributable to the letting – note that the final period exemption has to be excluded here).

In other words, it is £40,000.

This leaves £65,000 and, once Jasper has claimed his annual CGT exemption of £12,000 for 2019/20, a gain of £53,000 is assessable to CGT. If Jasper is a higher (or additional) rate taxpayer, his CGT liability will be:

$$28\% \times 53,000 = \text{£}14,840$$

In order better to focus private residence relief on owner-occupiers, the Government intend, from 6 April 2020, to restrict two of the ancillary reliefs which are thought to be overgenerous. The two reliefs which are affected are:

1. final period exemption; and
2. lettings relief.

By delaying these changes until 6 April 2020 (and the relevant legislation will therefore be included in FA 2020), HM Treasury say:

‘This timetable will give people sufficient time to rearrange their affairs (i.e.. by selling their property) under the current rules, should they wish to do so.’

Final period exemption

As mentioned above, the final period exemption ensures that no gain is taxable if it relates to the last 18 months of ownership of a property which is, or has been, an individual’s main residence. The intention of this exemption is to give people a CGT-free period in which to sell their property after leaving it.

However, the longer this final exemption period, the greater the relief which can be accrued on two dwellings simultaneously (i.e.. an unsold old one and a new one). This, say HM Treasury, ‘is out of line with the intention of the exemption’.

The final period exemption is therefore being reduced from 18 months to nine months for disposals taking place on or after 6 April 2020. It is estimated that this is still twice the length of the average property transaction. The special provision in S225E TCGA 1992 which gives the property owners in (d) above 36 months of exemption is being retained.

Lettings relief

Lettings relief was introduced in FA 1980 to ensure that property owners could let out spare rooms within their house or flat without losing the advantage of private residence relief. However, in practice, the regime extends somewhat further than the original policy intention and also benefits those who rent out an entire property which has previously been their main residence.

The change announced on 29 October 2018 will restrict the availability of lettings relief, which remains at a maximum of £40,000 per individual or £80,000 per couple, to those who share occupation of their property with a tenant. This revised rule will apply for all disposals made on or after 6 April 2020. HMRC state:

‘Shared occupation is considered to apply where the owner is residing in the same dwelling with the tenant and continues to occupy that dwelling as his/her only or main home throughout the period of the letting.’

It is envisaged that, where the property disposal takes place in 2020/21 or later, the sharing requirement will operate throughout the letting process (including any period which predates 6 April 2020).

In these circumstances, it may of course be possible for an owner, when he or she moves out, to take advantage of the absence relief in S223(3) TCGA 1992.

Extra-statutory concessions

In addition to the reforms discussed above, the Government intend to legislate two extra-statutory concessions which are of relevance to private residence relief, namely:

1. ESC D21 – late claims in dual residence cases; and
2. ESC D49 – short delay by owner-occupier in taking up residence.

It is assumed that this will be dealt with in FA 2020.

Inter-spouse transfers

Inter-spouse transfers of chargeable assets fall outside the scope of CGT. However, inter-spouse transfers of an only or main residence are subject to a special set of rules found in S222 TCGA 1992.

The basic CGT provision is that an inter-spouse transfer takes place on an automatic no gain no loss basis under S58 TCGA 1992. The transferee spouse acquires their interest in the asset on the date of the transaction, but at the transferor spouse's base cost.

Where there is an inter-spouse transfer of an interest in an only or main residence, the principle outlined in (s) above applies, but with an added twist. By virtue of S222(7) TCGA 1992, the recipient spouse's period of ownership is deemed to commence not at the date of the transfer but instead at the date of the transferor spouse's original acquisition. Furthermore, any period during which the property was the only or main residence of the transferor spouse will also be deemed to be that of the transferee spouse. Put simply, the transferee spouse stands in the shoes of their other half (i.e.. the transaction is backdated).

However, in order for the backdating regime to apply, there are two conditions which have to be satisfied. At the date of the transfer of the interest in the property the:

1. spouses must be married and living together; and
2. property in which the interest is being transferred must be the couple's only or main residence.

In the absence of either of these conditions, S222(7) TCGA 1992 does not apply and the general rule set out above holds sway. With a little careful planning, it is possible to turn this situation to a couple's advantage.

Illustration 2

Godfrey purchased a buy-to-let property in March 2009. Seven years later, he married Sally.

The couple decided to live in Godfrey's buy-to-let as their main home (the tenant had just left) and so Godfrey transferred his entire interest in the property to Sally shortly before they moved in. This was of course a no gain no loss disposal.

However, because the property was not the couple's main residence at the time of the inter-spouse transfer, it is treated as having been acquired by Sally at the time of the gift from Godfrey (i.e.. in March 2016, and not in March 2009).

Sally sold the property in March 2020 and, as it had been her main residence throughout her period of ownership, full private residence relief is available and no part of the gain is chargeable, despite the fact that the property was rented out for a seven-year period. In other words, Godfrey's gain is washed out by his judiciously timed inter-spouse gift.

The Government have indicated that they are thinking of amending this outcome by ensuring that a recipient spouse will always inherit the transferor spouse's period of ownership and use to which the property was put, even if it is not a main residence at the time of the transfer.

Contributed by Robert Jamieson

CIOT's view on the PPR changes

The Chartered Institute of Taxation (CIOT) stress the importance of communicating any new rules especially given the new requirement from April 2020 to report the disposal and pay any capital gains tax within 30 days of completion.

Additionally, the CIOT is suggesting that HMRC should conduct a broader consultation about the objectives and effectiveness of the relief and consider ways to streamline and rewrite the rules in a simpler format

Aparna Nathan QC, Chair of CIOT's CGT & Investment Income Sub-committee, said:

"It is important for HMRC to provide the evidence base that has been used to evaluate whether nine months is sufficient time for those who are genuinely trying to sell to move house particularly as there are likely to be large regional variations and differences depending on property values."

We are concerned that these changes indicate a trend towards repeatedly whittling away this important but admittedly costly relief. Regrettably, a simple relief has become overcomplicated, with scope for taxpayers to go wrong. It is unfortunate that in situations other than the most straightforward, home owners need professional help to determine the availability of the relief and/ or the extent of their liability."

The CIOT suggests that an alternative approach might be to link the final period exemption more closely to the period of owner occupation.

One way to achieve this could be to make the final period equal to the length of occupation as the main residence, but with a minimum period of nine months (or potentially less, perhaps down to three months) and a maximum of say, eighteen months or longer.

That way someone who only bought a property for a short period, or someone who only elected a main residence for a short period before changing the election back to another property, would only receive a very short final period exemption. Conversely, those who have occupied a property as their main residence for a longer period would receive the existing eighteen months (or longer) in which to sell the property.

<https://www.tax.org.uk/media-centre/press-releases/press-release-ciot-suggests-review-private-residence-relief>

Share by back

Summary – The sale and buy back of shares to the taxpayer represented a distribution taxable as dividend income.

Computer Aided Designers Limited was as an employment bureau for consultants and Bostan Khan was an accountant who acted for the company, preparing the management accounts. The company rented space at Mr Khan's offices.

Over the years, there was a number of disputes between the shareholders and so around 2009 they had decided they no longer wished to work together. A deal fell through in 2012 and so the shareholders decided to wind up the business, as they believed there was no real prospect of finding another buyer. In June 2013 the shareholders approached Bostan Khan to see if he wanted the company with a view to winding it up.

On 28 June 2013, Mr Khan bought the entire issued share capital (99 shares) of the company for £1.95 million but the company then immediately bought back 98 shares for the same amount; this was separately documented in an off-market purchase agreement.

Mr Khan contended that the disposal was of trading stock. He claimed that he intended from the outset to make money from the shares by winding-up the company within two years and he argued that a single transaction could amount to an adventure in the nature of a trade.

HMRC argued that when Mr Khan sold the 98 shares back to the company was a "distribution out of assets of the company in respect of shares in the company" and constituted dividend income.

Decision

The First Tier Tribunal said that the facts pointed against trading: it was a one-off transaction, unrelated to Mr Khan's accountancy practice; there was no evidence that he enhanced the value of the shares in any way.

The Tribunal concluded that the deal was not a trading transaction. He was not a securities' dealer but rather bought the company that he then held as an investment funded by the company's own reserves and borrowings

The taxpayer's appeal was dismissed.

Bostan Khan v HMRC (TC7052)

Penalty quashed for late NRCGT returns

Summary – HMRC had not told the couple that a separate return would be required on a timescale different from that applicable to Self Assessment returns. They had a reasonable excuse and the appeal was allowed.

In the 2013 autumn statement, it was announced that the UK planned to charge capital gains tax gains relating to the disposal by non-residents of UK residential property.

Mr and Mrs Kirsopp had been non-UK resident since 2003 but kept a property in the UK and so in March 2014, they telephoned HMRC to ask whether the sale of their former main residence would be subject to the new charge. They were told that it would be and that its sale should be reported in a Self Assessment tax return although the reporting process had yet to be finalised.

The taxpayers sold their former main residence in July 2015 and Mrs Kirsopp sold two other houses in March 2016 and August 2016. No capital gains tax was due. Their accountant reported the disposals in their self-assessment tax returns but he later discovered separate returns should have been submitted much earlier and these were made in September 2016.

HMRC imposed penalties for the late filed non-resident capital gains tax returns.

Decision

The judge did not accept HMRC's argument that a taxpayer is obliged to keep up with the law. He said:

'There is no such obligation in the statute: he or she has an obligation to comply with whatever law is in force but that law does not impose an obligation to stay up to date. If he or she does not keep up to date he or she may become liable to a penalty (depending on the circumstances) but that arises from an inexcusable breach of the law not from the failure to keep up to date.'

In this case, the First Tier Tribunal said the couple had acted reasonably. They phoned HMRC when they heard of the change. On the department's suggestion that the taxpayers became 'aware of the requirement to file a non-resident capital gains tax return' because they called HMRC in March 2014 about the changes, the First Tier Tribunal found the department had not told them a separate return would be required on a timescale different from that applicable to Self Assessment returns. The information they received was 'not such as to alert them to the likelihood of an imminent change which would require greater vigilance, but the opposite'. Indeed the reminders to file self-assessment returns provided some added comfort that no new action was needed.

The judge said the taxpayers could have checked HMRC's website regularly after the call, but that would have been the behaviour of a 'perfect taxpayer or of one who had had some intimation that there might be a special procedure'.

The taxpayers had a reasonable excuse and their appeal was allowed.

R and R Kirsopp (TC7064)

Adapted from Taxation (23 May 2019)

Frozen gain cannot disappear (Lecture P1141 – 13.28 minutes)

Summary – the Supreme Court found that a scheme intended to operate as a reorganisation should be treated as two separate conversions.

Mr and Mrs Hancock sold the entire share capital of Bluebeckers to another company in exchange for loan notes issued by the purchasing company.

The deal was structured in three stages:

Stage 1 was the exchange of Bluebeckers Ltd shares for Lionheart notes, which, being convertible into foreign currency, were not Qualifying Corporate Bonds (QCBs).

Stage 2: As a result of an earn-out provision dependent on the performance of the business, further loan notes were issued as QCBs.

Stage 3: Both sets of notes (QCBs and non-QCBs) were converted into one series of secured discounted loan notes that were QCBs. These QCBs were subsequently redeemed for cash.

The issue to decide was whether there was one disposal of exempt QCBs or two separate disposals:

- The Hancocks argued that the result of Stages 2 and 3 was that they were not chargeable to CGT as they were selling exempt QCBs;
- By contrast, HMRC argued that the two sets of loans notes should be treated separately, meaning that the gain relating to the original non-QCBs, that had originally been deferred, now crystallised.

The Court of Appeal had agreed with HMRC and the appeal moved to the Supreme Court.

Decision

In this case, the Hancocks crystallised a gain when they exchanged their shares in Bluebeckers Ltd for redeemable loan notes. This transaction was a reorganisation under s126 TCGA 1992. Rollover relief was available under s127 TCGA 1992 meaning that the gain on the original non-QCB loan notes was deferred.

The Supreme Court appreciated the strength of the Hancock's argument that s116 TCGA 1992 allows the possibility of a single transaction that involves a pre-conversion holding of both QCBs and non-QCBs. However, the court stated that if their interpretation was correct, it would be extremely easy for taxpayers to use the roll-over provisions to avoid CGT, rather than defer it. There was no magic whereby the frozen gain relating to the non-QCBs could on conversion "disappear in a puff of smoke."

Agreeing with the Court of Appeal, the Supreme Court stated that that 'the intention of Parliament was that each security converted into a QCB should be viewed as a separate conversion'. As a result, there had been two conversions: one of QCBs and one of non-QCBs. The gain relating to the original non-QCBs was chargeable.

Hancock and another v HMRC [2019] UKSC 24

Updated HMRC guidance (Lecture P1143 – 11.03 minutes)

Following the First-Tier Tribunal's decision in the *Warsaw* case that was published on 24 April 2019, HMRC have recently updated their guidance on the meaning of 'ordinary share capital'.

In the context of entrepreneurs' relief, this term has the meaning given to it by S989 ITA 2007 which states that the words cover all of a company's issued share capital (however described), other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the company's profits. There is an identical definition for corporation tax in S1119 CTA 2010.

On the authority of *Canada Safeway Ltd v CIR (1972)*, it is the nominal value of the ordinary shares rather than the number of ordinary shares issued or the amount subscribed for those shares which must be taken into account for the purposes of S989 ITA 2007.

HMRC's CT Structure Team have technical responsibility for the interpretation of S989 ITA 2007 (and S1119 CTA 2010) and their official guidance on what constitutes 'ordinary share capital' can be found in Para CTM00514 of the Company Taxation Manual. In particular, the guidance now includes a table which sets out HMRC's view on whether a number of different types of share are likely to be classified as 'ordinary share capital'. However, HMRC emphasise that some of the classification issues are 'finely balanced'.

Notably, the tax officials express the opinion that fixed rate preference shares with rights in a liquidation (e.g. to a distribution of surplus assets) will not usually be regarded as 'ordinary share capital', but they do confirm that this is fact-dependent. In addition, the position of preference shares:

- where the coupon compounds over time; or
- where a rate of interest is added if a dividend is unpaid

is described as 'borderline' and fact-dependent. The decision in *Warsaw v HMRC (2019)* is referred to as being of 'persuasive' rather than 'precedent' authority. Does this imply that HMRC do not intend to take their defeat in the *Warsaw* case any further?

Contributed by Robert Jamieson

Incorporating a property portfolio (Lecture P1144 – 23.05 minutes)

Consider a client who has been buying residential properties over a number of years. The client and his wife are in their mid 60s and have only just started to think about IHT - a very common scenario and a real problem.

They have a portfolio of around 40 properties that they actively manage themselves. The rental income is their main source of income. State pensions will supplement this shortly.

As things stand, most of the current value of their estates is represented by the net value of their UK property business. The properties are currently valued at approximately £10 million. Outstanding mortgages against the properties currently total approximately £3 million.

If no advance planning is put in place, the IHT exposure in relation to their property business will be approximately £2.8 million!

This tax would be suffered by the beneficiaries of their estate. The beneficiaries could make an application to HMRC to pay this tax in 10 annual instalments (thereby deferring the need for their descendants to make immediate property sales to meet the liability). However, the tax - plus accrued interest on the instalments - would be payable in due course and would inevitably require sales of several of the properties.

Advice

Securing IHT Business Property Relief (BPR) on their property business would be an effective way to remove their IHT exposure. This can be achieved by transferring all their properties to a new company managed and controlled by the couple. Over a period of time the buy to lets would be sold to fund development opportunities in the company – we are essentially changing their business model from buy to let to property development.

Clients in this area generally feel comfortable with all aspects of property and given an influx of cash they may be able to take advantage of development opportunities that come their way. As and when tenancies come to an end they could look to sell the property rather than re-let. The clients would then need to move the money into development projects. Over the next 10 to 15 years the nature of the business could gradually transform into property development rather than letting. The couples children could be directors of the company and provide the energy to push the development motives forward in the long term.

BPR will be available on the shares in the new company provided that the company's main activity is the development of land in the two years to date of second death (assuming inter spouse on first death).

Some properties can then be retained for letting without this prejudicing BPR.

The transfer of their property business to the new company can be achieved free of CGT and SDLT. The SDLT savings are dependent on a positive review by an SDLT specialist concerning the existence of a partnership and the 'sum of lower proportions' principles applying on incorporation. In my opinion a couple running a property business of this size would have grounds for partnership status irrespective of whether there is a written partnership agreement, partnership returns etc.

IHT saving

IHT can be saved by securing BPR on the value of the property business. This can be achieved by forming a company to hold the properties and then securing BPR on the value of the shares.

The client would form a company and husband and wife would each have 50% of the issued shares. Those shares will qualify for BPR once they have been relevant business property for 2 years.

To be relevant business property, the business carried on by the company must not be one of 'dealing in land'.

A company that acquires land with a view to selling it on after it has appreciated in value, perhaps after the grant of planning permission, will be a business which is 'dealing in land' and is excluded from BPR.

However, a building company or property development company that operates a business of constructing houses or other properties for resale, will qualify for BPR.

This understanding is confirmed by HMRC in their IHT Guidelines which confirm that BPR is available for a business which at the time of the transfer:

- 1) Is carrying on a genuine building and construction business holding a number of properties (for example, houses or plots awaiting development) as stock in trade; or
- 2) Is a property development company provided that;
 - a) The land is acquired with a view to the development and disposal of the completed development; and
 - b) Most of the profit is derived from the enhanced value of the property resulting from the development (as opposed to increases in the value of the land from the obtaining of planning permission or a general rise in land values).

Case law clarifies HMRC's position by saying that a company whose business it is to acquire land with a view to promoting a development, and then realising the developed land once subcontracted building work has been completed, is not a land-dealing company. This emphasises the point that the development must be entered into for the purposes of an onward sale and not with the intention of retaining the properties for letting.

There can be a fine line between what constitutes 'property development' and what constitutes 'dealing in land', particularly in cases where the site is developed but the completed properties are then let for a period rather than sold (perhaps, for example, due to the absence of buyers in the market).

To maximise the potential for the shares in the new company to qualify for BPR, the client must have a clear intention throughout the process to develop land or properties for sale, and this should be recorded in Board Minutes and company accounts. If the company diverts from this original plan, the reasons for doing so should also be documented.

Case law also suggests that the business activity needs to be commercial. A business plan is recommended to show that the intention at the outset is for the business to be profitable. This helps avoid any claims by HMRC that the development is 'fake' and only exists for the purposes of securing BPR. I would therefore recommend that a professional business plan is drawn up before any project begins.

It is important that the business is a genuine property development business "at the time of the transfer". The 'transfer' is the event which triggers the charge to IHT. It is likely that the couple have Wills which leave their respective estates to each other with the survivor's estate then passing to your descendants on the second death. As transfers between spouses are fully exempt from IHT, this means that no IHT will be due on the first death. The conditions for BPR do not therefore need to be satisfied until the death of the survivor.

This could give the company the additional time to really establish itself as a development company.

On second death BPR will be secured if there is a business consisting of the development of land with the intention of resale and the surviving spouse has had that business for two years. It is not essential that a project is complete or that any of the developments have been actually sold, as long as it is clear to HMRC that the company is in the process of actively developing for sale.

Retaining properties for letting

Some businesses will engage in both property development and the holding of let properties. HMRC call such businesses 'hybrids'. It is likely that many companies will operate such a hybrid business.

BPR is available on shares in a company that is "wholly or mainly" engaged in trading activity (property development being a trading activity). "Mainly" in this context means more than 50%. This means that as long as more than half of the activities of your company are concentrated in property development, the shares will be eligible for BPR.

Activities are measured by looking at criteria such as business turnover, assets employed, expenses incurred, and time spent by directors in managing the company. As existing rental properties are sold by the company to fund the development, the activities will gradually shift more into the development side such that we will reach a point where the company is "mainly" trading.

This will be the tipping point for BPR. That point will then start the "clock" running, and once two years have elapsed from that date, BPR will become available.

This 'wholly or mainly' approach means that development companies can hold some stock for property letting without this prejudicing BPR. HMRC accepts that where a trading company has a secondary non-trading business – for example, property letting – BPR is available on the full value of the shares without any restriction. This is because the let properties are still used in the wider business of the company, albeit not used to generate trading profits.

For example, if you have a company worth £6 million of which £4 million of its assets are employed in the property development side with the remaining £2 million of assets being properties held for letting, it does not necessarily follow that BPR is restricted to 4/6ths of the value of the shares. As long as the property rental arm is run as a "business" – requiring a degree of activity and input from the company directors as opposed to the properties merely being held as passive investments – the full value of the shares will qualify for BPR.

Forming the new company

Creating a new company is quick and inexpensive.

The client would need to choose a name – preferably with the words "property development" in there somewhere! The clients' would be 50:50 shareholders and co-directors (certainly to start with – their older children can come on board as directors and become more actively involved as the development progresses).

Once the company is formed, the clients would then transfer the whole of their property business to the new company. This will require a solicitor re-registering each of the properties in the name of the company. New financing will be required in the company name to repay the existing funding.

The clients would be disposing of their properties meaning that the transfer has CGT implications. However, where the whole of a business is transferred to a company in exchange for shares, the gains arising on the transfer can be deferred. 'Business' in this case will include a property business. The effect of the deferral is that the shares in the new company will inherit the same CGT base cost as that of their current property business.

CGT only then becomes an issue if the shares in the company are either sold or gifted during the client's lifetime. If they were to retain the shares until their death, the deferred gains would be extinguished and the recipients of the shares would inherit them at an uplifted CGT base cost equal to their probate value.

From the company's perspective, it would be treated as acquiring each property at its value at the date of the transfer. This means that as and when properties are sold by the company to fund development projects, chargeable gains within the company structure are likely to be very low.

The company would pay corporation tax on its rental profits. The current corporation tax rate is 19% but this is falling to 17% shortly.

The client would no longer pay income tax on these rental profits. Instead they would pay tax on any dividends declared by the company. The current dividend rates are 7.5% for basic rate taxpayers and 32.5% for higher rate taxpayers with the first £2,000 of annual dividends being tax-free.

The other advantage of holding property via a company structure is that the new rules on interest restrictions for individuals do not apply to companies.

SDLT issues

As a general rule, there is no SDLT charge when properties are transferred to a company for no consideration. However, there is an important exception to this principle in that S53 FA 2003 imposes a market value charge if:

- (i) property is transferred to a company; and
- (ii) the transferor is connected with the company (see S1122 CTA 2010 for the meaning of 'connected').

Given that several rental properties will often be put into the company at the same time, this is likely to involve an unacceptably high SDLT charge since they will constitute 'linked' transactions (see S108 FA 2003). At present, the maximum rate is 15% on the top slice of the value acquired by the company.

There are three main ways by which this charge can be mitigated:

- (i) The first is to take advantage of an important deeming rule in S116(7) FA 2003 where six or more properties are involved. Under s.116(7) the properties are treated as one commercial purchase and as such you avoid the additional 3% when corporates buy residential property.

So if 20 properties had a total valuation of £5m the SDLT would be £239,500 i.e. the first £150,000 of consideration is charged at 0%, the next £100,000 at 2% and the balance at 5%. SDLT of **£239,500** is a significant sum but a mortgage free property could be sold to settle this liability.

- (ii) The second relief is known as 'multiple dwellings relief' (MDR) under FA 2003 Schedule 6B. For this you work out the residential SDLT on the average value of one property – and then multiply the result by the number of properties to arrive at the total SDLT due. Do remember that corporates have a 3% supplement on each SDLT rate band.

So a £5m valuation divided by 20 properties gives an average value of £250,000. Residential SDLT on £250,000 is £10,000 being £125,000 at 3% and £125,000 at 5%. For 20 properties this would amount to **£200,000** so it would be more beneficial to claim MDR in this instance. Again, one mortgage free property could be sold to clear this liability.

- (iii) The third arrangement is more complicated but can sometimes eliminate the SDLT charge completely. It requires a partnership – or, better still, an LLP – to transfer the properties to the company and the relevant legislation is set out in Sch 15 FA 2003. It is important to appreciate that the partnership SDLT provisions take priority over the market value rule in S53 FA 2003 – see Para SDLTM34160 of the Stamp Duty Land Tax Manual for confirmation of this statement. The salient measure is found in Para 18 Sch 15 FA 2003 which uses the following formula to determine the quantum of the SDLT charge:

$$MV \times (100 - SLP)\%$$

where:

- MV = the market value of the properties transferred; and
- SLP = the 'sum of the lower proportions'.

The SLP definition is provided by Para 20 Sch 15 FA 2003. This involves what is essentially a three-step procedure:

Step One

Identify the partners who are connected persons and who have an interest in the properties after the transaction (ie. through their shareholdings) – they are known as 'relevant owners'.

Step Two

For each relevant owner, find their percentage interest in the properties after the transaction.

Step Three

Add together all these percentage interests – this produces the SLP percentage.

Note that the SLP will be 100 where these partners (eg. husband and wife or mother and daughter) become the only shareholders in the new company. In these circumstances, the application of the above formula will always produce a tax rate of 0%. This is the case even if the aggregate market value of the properties transferred into the company is, say, £8,000,000.

So if the couple are operating as a partnership there will be no SDLT on the transfer of their property business. This couple may not have a written partnership agreement or have ever submitted a partnership tax return BUT they could be operating as a partnership for SDLT purposes. What if this has been their only business for the past 15 or so years and they run it together – seven days a week. The husband and wife could find the properties, her husband obtains the finance and deals with the refurbishments and the wife is the main point of contact for tenants. A profit and loss account is prepared and they split the profit 50:50. In my opinion this would be a true partnership – the lack of paperwork should not alter this fact.

IHT residence nil rate band and FA 2019 (Lecture P1145 – 23.18 minutes)

The concept of the residence nil rate band was introduced by the previous Chancellor on 8 July 2015. The legislation was set out in F(No2)A 2015 and took effect on 6 April 2017. This IHT relief represents an additional nil rate band which is conditional upon a residential property being passed on death to one or more direct descendants. The residence nil rate band currently has a limit of £150,000, rising to £175,000 in 2020/21. Any unused residence nil rate band can be transferred to a surviving spouse (or civil partner) who meets the relevant requirements. For estates with a net value of more than £2,000,000, there is a tapered withdrawal of the relief which operates at the rate of £1 for every £2 of value over the £2,000,000 threshold.

Following FA 2016, the residence nil rate band is also available where a person downsizes their residence or ceases to own a home on or after 8 July 2015, given that the former home would have qualified for the residence nil rate band had it still been owned. In this situation, assets of an equivalent value, up to the limit of the relevant residence nil rate band, can be passed on death to one or more direct descendants on a tax-free basis.

S66 FA 2019 makes amendments to the residence nil rate band, with the key change clarifying the operation of the downsizing provisions so that they accord with the Government's original intentions (which previously they did not). Unfortunately, the new legislation, which applies to deaths occurring on or after 30 October 2018, is less favourable to taxpayers than the old rules were.

The key change referred to above can be found in S66(3) FA 2019 which amends Step 2 of S8FE(9) IHTA 1984. Step 2 of S8FE(9) IHTA 1984, which was introduced by FA 2016, was initially described as follows:

‘Express QRI as a percentage of the person's allowance on death, where QRI is so much of VT as is attributable to the person's qualifying residential interest, but take that percentage to be 100% if it would otherwise be higher.’

For this purpose:

- QRI, which stands for ‘qualifying residential interest’, means the portion of value transferred under S4 IHTA 1984 which is attributable to the qualifying residence;
- VT, which stands for ‘value transferred’, means the value transferred by the chargeable transfer (the speaker’s italics) under S4 IHTA 1984.

The new version of Step 2 reads:

‘For “VT” substitute “the value transferred by the transfer of value (the speaker’s italics) under S4 IHTA 1984”’. As a result, the requirement of Step 2 is:

‘Express QRI as a percentage of the person’s allowance on death, where QRI is so much of the value transferred by the transfer of value under S4 IHTA 1984 as is attributable to the person’s qualifying residential interest, but take that percentage to be 100% if it would otherwise be higher.’

It is important to appreciate the critical IHT distinction between ‘transfers of value’ and ‘chargeable transfers’. A transfer of value is defined by S3 IHTA 1984 as any disposition made by a person as a result of which the value of that person’s estate immediately after the disposition is less than it would be but for the disposition. On the other hand, a chargeable transfer is any transfer of value made by an individual that is not an exempt transfer (as defined) – see S2 IHTA 1984.

Until 29 October 2018, only the value of the qualifying residential interest comprised in the deceased’s estate which is part of the ‘chargeable transfer’ was counted, whereas, in the future, the value of the qualifying residential interest comprised in the deceased’s estate which is both chargeable and exempt has to be considered. In other words, this point is relevant where a residential property passes on death in part to, say, a surviving spouse (i.e.. an exempt transfer) and in part to a direct descendant such as a son or daughter (i.e.. a chargeable transfer).

Case study

Neil, who is married, downsized from a house worth £400,000 to a bungalow in March 2019. The maximum residence nil rate band for 2018/19 is £125,000.

Neil died in February 2021, leaving the bungalow (which was valued at £105,000) to his widow and daughter equally. He also left shares and other assets worth £480,000 to his son. The maximum residence nil rate band for 2020/21 is £175,000.

Prior to FA 2019, the correct statutory calculation of Neil’s residence nil rate band should have proceeded as follows:

Step 1: The maximum residence nil rate band at the date of the downsizing was £125,000. Neil’s house was worth £400,000 when it was sold. Divide this latter value by the maximum residence nil rate band at the date of the downsizing and express the result as a percentage. However, this can never exceed 100% (which is what we have here).

Step 2: When Neil dies, the bungalow is worth £105,000. The correct figure to be used in Step 2 is one half of this amount, given that a half-share was left to an exempt legatee and so the value transferred by Neil’s chargeable transfer (i.e.. the half-share left to the

daughter) was only £52,500. Divide this value by the maximum residence nil rate band available at the date of his death (£175,000) and express this as a percentage, i.e.. 30%.

Step 3: Deduct the percentage found in Step 2 from the percentage found in Step 1, i.e. $100\% - 30\% = 70\%$.

Step 4: Multiply the maximum residence nil rate band at the date of Neil's death by the percentage found in Step 3. This produces $70\% \times £175,000 = £122,500$ – it represents Neil's 'lost' residence nil rate band.

Neil only leaves one half of the bungalow to his daughter. So the residence nil rate band due for that home is:

$$\frac{1}{2} \times 105,000 = £52,500$$

Given that Neil leaves shares and other assets worth £480,000 to his son, the downsizing addition is the lower of:

- (i) his 'lost' residence nil rate band (£122,500); or
 - (ii) the value of shares and other assets bequeathed to a direct descendant (£480,000),
- i.e.. £122,500.

This amount should be added to the residence nil rate band relating to the bungalow (£52,500) to give a total relief of £175,000.

Neil's chargeable estate is:

	£
Bungalow	105,000
Shares and other assets	<u>480,000</u>
	585,000
Less: Spouse exemption	<u>52,500</u>
	<u>£532,500</u>

Given that Neil's aggregate nil rate bands will total $£325,000 + £175,000 = £500,000$, the IHT payable on Neil's death estate is:

$$\text{On } 500,000 - 532,500 = 32,500 @ 40\% \quad \text{£13,000}$$

Revised calculation

Following the changes instigated by FA 2019, the revised calculation will be:

Step 1: As before

Step 2: The value transferred by Neil's transfer of value (i.e.. the whole value of the bungalow) is £105,000. Divide this value by the maximum residence nil rate band available at the date of his death (£175,000) and express this as a percentage, 60%.

Step 3: Deduct the percentage found in Step 2 from the percentage found in Step 1, i.e.. $100\% - 60\% = 40\%$.

Step 4: Multiply the maximum residence nil rate band at the date of Neil's death by the percentage found in Step 3. This produces $40\% \times £175,000 = £70,000$ – it represents Neil's new 'lost' residence nil rate band.

Neil only leaves one half of the bungalow to his daughter. So the residence nil rate band due for that home is:

$$\frac{1}{2} \times 105,000 = £52,500$$

Given that Neil leaves shares and other assets worth £480,000 to his son, the downsizing addition is the lower of:

- (i) his new 'lost' residence nil rate band (£70,000); or
- (ii) the value of shares and other assets bequeathed to a direct descendant (£480,000),

i.e.. £70,000.

This amount should be added to the residence nil rate band relating to the bungalow (£52,500) to give a total relief of £122,500.

Neil's chargeable estate is (as before):

	£
Bungalow	105,000
Shares and other assets	<u>480,000</u>
	585,000
Less: Spouse exemption	<u>52,500</u>
	<u>£532,500</u>

Administration

Investigations and discovery assessments (Lecture P1141 – 13.28 minutes)

Summary – The discovery assessment was valid and HMRC had been entitled to obtain information on a voluntary basis as part of an investigation.

HMRC had received information from the police suggesting that Mr Hunter had diverted and retained confidential cash payments from his company. HMRC wrote to Mr Hunter in February 2015 informing him that it was opening an investigation.

Following the investigation, HMRC considered that two sums credited to Mr Hunter's bank account represented undeclared income, and issued a discovery assessment.

The issue was whether the discovery assessment was valid.

Decision

The first question was whether the discovery assessment was stale, given that the insufficiency of tax had been discovered long before the assessment was issued. The tribunal accepted that the relevant HMRC officer did not believe that he had discovered a tax loss at the time of receipt of the information from the police in late 2014, by the time he opened his investigation in February 2015 or by the time of his meeting with Mr Hunter in April 2015. The officer had only made the relevant discovery 'between November 2016 and February 2017' when he had received an unsatisfactory explanation for the credits in Mr Hunter's bank account. The seven-month delay between the discovery and the issue of the assessment was a 'reasonable passage of time', as during that time HMRC and Mr Hunter had 'made attempts to settle matters.'

The First Tier Tribunal found that Mr Hunter had been careless in not declaring the relevant income or keeping records. He believed that he did not need to keep records as the receipts were not taxable income. However, the Tribunal found that both credits were taxable receipts. In the absence of any documentation, it rejected Mr Hunter's contention that the credits represented a loan, and found that they were likely to be payments for work performed by him.

K Hunter v HMRC (TC07140)

Adapted from case summary in Tax Journal 31 May 2019

Late filing of return

Summary – As HMRC were aware of the underpayment of tax when issuing a P800, it was not possible for them to issue a valid notice to file a self – assessment return.

Simon Hurst appealed against penalties imposed by HMRC for the late filing of his self-assessment return. He argued that it was not necessary for him to file a self-assessment return as he had been in full time employment since 2012, with no income other than salary and benefits from his employment, details of which were available to HMRC from his P60 and P11D, and sundry interest, details of which were available to HMRC via financial institutions.

Decision

The First-tier Tribunal considered two conflicting decisions:

1. In *Goldsmith v HMRC*, the Tribunal had held that using the self-assessment system to collect unpaid tax from a person within the PAYE system was inappropriate, and penalties imposed on a taxpayer for not submitting a return in such circumstances were therefore invalid.
2. In *Crawford v HMRC*, the Tribunal had found that an assessment 'fixes or settles a person with liability to the tax as calculated', and that a notice under TMA 1970, s 8 may validly be issued simply to assess a known liability to tax. The Tribunal noted that this conflict could only be resolved by a decision of the Upper Tribunal or a higher court.

In this case the First Tier Tribunal concluded that Simon Hurst had expressly relied on *Goldsmith*, whilst HMRC had not presented submissions on case law. Following *Goldsmith*, the Tribunal concluded that HMRC were aware of the underpayment of tax when it issued the P800. Accordingly, it was not possible for them to issue a valid notice to file a return.

Simon Hurst v HMRC (TC07125)

Supply Chain Fraud (Lecture P1141 – 13.28 minutes)

HMRC is aware of increasing levels of fraud in labour supply chains and with companies offering payroll services. HMRC recognises that these arrangements are mostly used legitimately, however, they would like employers to take extra care when engaging with these services.

Payroll Company Fraud, at its most basic, occurs when a business transfers staff and payroll responsibility to a fraudulent Payroll Company who supply the staff back to the business. When they are fraudulent, these Payroll Companies will not make the necessary payments to HMRC for Income Tax, National Insurance Contributions or VAT.

The companies conducting the fraud are not limited to specific sectors or business types – providing there is a workforce and a subsequent need for a payroll function, they can target any business. However, they are more likely to target companies whose financial position is weak, almost certainly to exploit this vulnerability with cheap payroll services, offering the struggling business an opportunity to cut in-house payroll costs.

The fraudsters can offer cheap services as, ultimately, they're stealing the tax and National Insurance contributions.

Co-Employment

The co-employment model is something we have seen more often recently. This is generally defined as when control and supervision of an employee's activity is shared amongst two or more business entities. One company will be the original employer and the other/others will take over the personnel related functions, claiming that the workforce is employed jointly by all companies.

There are a number of risks that can occur here – primarily with the new company set-up accruing debts to HMRC and then dissolving. Businesses entering into a co-employment model should undertake sufficient due diligence to ensure the business arrangements are tax compliant.

Mini Umbrella Companies

An umbrella company is a company that acts between the ultimate employer and the staff doing the work. The workforce is segmented into small companies with, usually, a very small number of employees in each company. This is done with the intention of exploiting specific allowances designed to help small businesses, with the aim of reducing the tax paid to HMRC.

With some of these schemes, promoters will offer “payroll services” to legitimate employment agencies, at a rate that is not commercially viable, sometimes with the offer of financial inducements to win the contract.

Employers need to be vigilant

If it can be shown that a company knew, or should have known, that transactions in their supply chain are linked to fraud they may lose the right to recover VAT paid on these transactions. Additionally, in some cases, they may also still be liable for any unpaid tax or National Insurance.

HMRC recommends that business undertake sufficient and proportionate due diligence checks before entering into an arrangement with a payroll or umbrella company.

www.gov.uk/government/publications/employer-bulletin-june-2019

Deadlines

1 July 2019

- Corporation tax due for periods to 30 September 2018, if not liable to pay by instalments

5 July 2019

- Non-resident landlords' scheme forms NRLY and NRL6
- Report non-cash benefits not from a registered pension scheme

6 July 2019

- Complete forms P9D, P11D, P11D(b) for 2018/19
- Taxed award scheme returns
- Details of redundancy packages 2018/19 worth more than £30,000 to HMRC
- File forms 42

7 July 2019

- Due date for VAT return and payment for 31 May 2019 (electronic payment)
- Election to aggregate beneficial loans in 2018/19

14 July 2019

- CT61s for quarter ended 30 June 2019
- Monthly EC sales list — paper returns

19 July 2019

- Pay PAYE/CIS for month ended 5 July 2019 — cheque
- Pay PAYE for q/e 5 July 2019 if average monthly liability is less than £1,500
- Pay 2018/19 class 1A NICs — cheque

21 July 2019

- Online monthly EC sales list
- Intrastat — payment of supplementary declaration for June

22 July 2019

- PAYE/NIC/student loan payments online
- Pay 2018-19 class 1A NICs electronically

31 July 2019

- Accounts to Companies House:
 - private companies with 31 October 2018 year-end
 - plcs with 31 January 2019 year-end
- Second 5% surcharge for unpaid 2017/18 balancing payments
- 2018-19 second instalment SA liabilities
- Tax credits claims finalised and renewed
- CTSA returns for accounting periods ended 31 July 2019

HMRC News

Revenue Scotland upgrade

Revenue Scotland is undertaking a programme of work in July to upgrade its online tax portal, the Scottish electronic tax system (SETS), which will affect filing of LBTT and SLfT tax returns.

They say that the new system will include postcode validation and address lookup, as well as real time updates to account balances.

Current SETS users will be able to access the new system using their current username but will be required to set up a new password.

Revenue Scotland expects to switch off the old system at 4pm on Thursday 18 July. Checks and testing will take place over the weekend and early part of week beginning 22 July. The new system is expected to go live at midday on Wednesday 24 July 2019.

Taxpayers and agents should avoid submitting returns during the downtime period. If this is not possible, paper returns can be submitted. New paper return forms for both LBTT and SLfT will be available from the Revenue Scotland website from 18 July. Paper returns must be submitted with a cheque to cover payment of any tax due, as BACS is not available for paper returns.

From Friday 19 July, paper returns for LBTT must be sent to Revenue Scotland instead of Registers of Scotland. Any forms sent to Registers of Scotland after this date could face a delay in processing.

www.revenue.scot/about-us/upgrading-scottish-electronic-tax-system

Maturing child trust funds

Child Trust Funds (CTF) begin maturing in September 2020 as account holders reach their 18th birthday and can access their accounts.

HMRC are consulting on changes to the Regulations to be introduced that look to ensure that funds:

- retain their tax-advantaged status after September 2020; and
- where transferred to an ISA, are disregarded as part of the annual ISA limit.

This technical consultation is designed to gather views on the detail of draft regulations.

The changes to the CTF Regulations will provide that, where, at maturity, no instructions have been received from the account holder on the future of the investments in the CTF, the CTF provider will be required to transfer the investments to a tax advantaged 'matured account' pending instruction.

The 'matured account' can be a continuing CTF account, or a cash ISA or stocks and shares ISA offered by the original CTF provider.

Funds in the 'matured account' will retain their tax advantaged status, and the terms and conditions which applied before maturity. No subscriptions can be made to the matured account and the matured account must be retained by the original provider.

The changes to the ISA Regulations will provide for the investments to be transferred to an ISA at, or post, maturity outside the annual ISA subscription limit but subject to the Lifetime ISA payment limit. This is consistent with the approach taken for maturing Junior ISAs.

www.gov.uk/government/consultations/draft-regulations-maturing-child-trust-funds

GAAR advisory panel opinions

Two more opinions have been published relating to:

1. Disguised remuneration involving offshore insurance bonds and loan arrangements;
2. Close company loans to participators involving second-hand bonds and gilts options

These summaries have been taken from Tolleys Guidance Daily Round Up.

Disguised remuneration involving offshore insurance bonds and loan arrangements

The scheme promoter, a company, paid an initial premium of £5,000 to set up an offshore life assurance bond for its directors. A limited liability partnership set up a loan facility for the promoter, with the promoter's interest in the bond as security. The promoter drew down £1.5m on the loan and contributed £1,518,331.65 as a top-up premium on the bond.

At this point, the taxpayers acquired the bond from the promoter. The taxpayer company paid £179,000 and took over the promoter's liability for the amount drawn under the loan facility and became bound by the charge over its interests in the bond, while the individual director paid £1,000, guaranteed the taxpayer company's liability and became bound by the security in respect of the bond.

The individual director then entered into a gilts option involving a payment of £1.5m in gold due to him on the settlement date. The individual subsequently novated his position in the gilts option to the bond manager, removing both his entitlement to the premium and exposure to risk, and contributed a further £1,000 into the bond assets, carrying with it certain 'cooling off rights'.

On the settlement date, the individual exercised his 'cooling off rights', reversing novation of the gilts option and requiring withdrawal of the £1,000 contribution, following which he became entitled to receive the £1.5m premium in gold. The individual directed the premium to be paid to the limited liability partnership, discharging the loan for which the taxpayer company had assumed liability and the individual's own contingent liability under the guarantee. The taxpayer company credited this discharge amount to the individual director's loan account. The bond was subsequently cancelled.

The company claimed a corporation tax deduction for the difference between the amount it paid for the bond and the much lower value of the bond after the final transactions, describing the deduction as 'director's remuneration'.

The panel summarised the outcome of the arrangements as follows:

- individual had paid £1,000 to acquire his interest in the bond and had obtained the right to receive £1.5m from the company;
- taxpayer company had paid £179,000 for the Bond and had paid or become liable to pay £1.5 million to the individual;
- promoter had made an initial investment in the bond of £5,000 and had received £180,000 on sale of the bond to the taxpayers;
- limited liability partnership loaned £1.5m and was repaid £1.5m;
- bond manager received cash contributions of £5,000, £1,518,331.65 and £1,000, returned through the combination of a mirror option and the exercise of cooling off rights.

The most likely comparable commercial transaction would have involved a cash bonus paid to the individual director as remuneration. In effect, the arrangement resulted in the individual receiving £1.5m in a form the taxpayers claimed was not earnings, even though the company claimed a deduction for an amount described as 'director's remuneration'.

The panel decided the entering into of the tax arrangements was not a reasonable course of action in relation to the relevant tax provisions, and the 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-11-april-2019-employee-rewards-using-a-second-hand-bond-gilt-options-additional-contributions-and-cooling-off-right

Close company loans to participators - second-hand bonds and gilts options

The taxpayers acquired an offshore bond for £275,000, the shareholders each contributing £1,000, with the company contributing £23,000 and assuming a £250,000 liability. One shareholder (Mr A) provided a guarantee of £85,000, while the other (Mr B) provided a guarantee of £165,000, together covering the company's liability of £250,000.

The shareholders then entered into gilts options under which Mr A was entitled to a premium of £85,000 with a 5% risk of having to make a £1.7m gilt settlement to the option purchaser on expiry, and Mr B was entitled to a premium of £165,000 with a 5% risk of having to make a £3.3m gilt settlement to the purchaser on expiry.

The shareholders subsequently made an additional contribution into the offshore bond of £1,000 each, plus the options by way of novation. The additional contribution carried 'cooling off' rights. The bond manager entered into a hedging mirror option.

The options expired 'out of the money' without requiring payment in settlement and the shareholders exercised their 'cooling off' rights. This reversed the novations and Mr A became entitled to the £85,000 premium and Mr B to the £165,000 premium. The mirror option expired and premiums of £250,000 were paid, reducing the offshore bond value by £250,000. The shareholders' premiums were used to meet their guarantee of the company's liability in respect of the offshore bond.

The company credited £85,000 to Mr A's loan account and £165,000 to Mr B's loan account. The offshore bond became effectively worthless and the company's assets were reduced by £273,000.

The panel's view was that the shareholders had not taken any material financial risk under the arrangements and the company had not been in a position to make a profit. The purpose of the arrangements was the extraction of value by the shareholders from the company, the most likely comparable commercial transaction being a dividend or other cash distribution of:

- £85,000 paid by the company to Mr A with that amount being credited to Mr A's loan account; and
- £165,000 paid by the company to Mr B with that amount being credited to Mr B's loan account.

The panel decided the entering into of the tax arrangements was not a reasonable course of action in relation to the relevant tax provisions, and the 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-12-april-2019-extraction-of-value-using-a-second-hand-bond-gilt-options-additional-contributions-and-cooling-off-ri

Business Taxation

Regulation of agents by professional bodies

Around three in four businesses use a tax agent to help deal with business taxes, as well as wealthier individuals, self-employed and/or those with more complex tax affairs. Professional bodies, rather than HMRC, regulate the actions of their members, with some 67% of agents being members of such bodies.

The report, 'Role of professional bodies in the regulation of tax agents', is based on research involving interviews with senior officials of 15 professional bodies that looked to provide a better understanding of:

- Membership requirements of professional bodies;
- The role of professional bodies;
- How professional bodies assess the adherence of members to agreed standards;
- Where professional bodies believe opportunities exist for the profession to enhance its use of regulation or other means to improve standards of tax agents; and
- The relationship between professional bodies and HMRC and maximising the effectiveness of HMRC's support.

In terms of regulation, the professional bodies that supervised, or reviewed, their members considered that self-regulation generally worked well, and that statutory supervision was sufficient. A couple of the professional bodies whose current focus was advocacy were considering developing a review system to maintain and enhance standards.

Of greater concern to many of the professional bodies were agents that were not members. While they may be providing a high-quality practice, there was no guarantee of this and the lack of oversight was a concern.

Six suggestions were made to bring the 'un-regulated' into a position where they may be supervised:

1. A couple of the professional bodies suggested that all agents should be required to be a member of, and supervised by, a professional body, although there were mixed views about this as it could be a restriction on trade;
2. There were several suggestions for the introduction of legal protection of titles, such that only those professionals who met certain criteria would be legally allowed to use a specific title; for example, 'professional tax adviser'. There could be unintended consequences, with agents who did not meet the specified criteria, but were providing perfectly adequate services, being unable to practice;
3. A public education campaign highlighting the role and importance of professional body supervision was suggested by one professional body, to aid the public and businesses when selecting an agent;

4. A couple of the professional bodies were considering whether there were ways in which to bring agents that did not meet their usual criteria into their supervisory process but with a different level of membership;
5. One of the professional bodies suggested the development of 'Regulatory Assurance Packages' that could be subscribed to by agents who do not currently meet the criteria for membership but would bring a level of supervision and oversight; and
6. A couple of professional bodies suggested that agents who are supervised in some way receive a different level of service from HMRC, or are able to access a greater number of HMRC services on behalf of their clients.

The professional bodies are also keen to continue working with HMRC to maintain and enhance professional standards. Some areas of particular interest are:

- HMRC's thinking about the supervision of agents who are not currently members of a professional body;
- earlier, greater input into the development of HMRC's new policies, processes and systems as a means of highlighting any potential pitfalls;
- more detailed information about the type of tax errors being made by agents;
- greater clarity about when information provided by HMRC in the forums can be released to members;
- longer lead times where HMRC wishes the professional bodies to send information to their members; and
- how HMRC plans to use the memorandum of understanding it has with some of the professional bodies allowing HMRC to notify them about individual members that may not be acting professionally.

www.gov.uk/government/publications/role-of-professional-bodies-in-the-regulation-of-tax-agents

Late CIS returns – HMRC evidence lacking (Lecture B1141 – 17.36 minutes)

Summary – With no evidence provided by HMRC to support their appeal, only one of the penalty notices imposed on the company for the late filing of CIS returns was valid.

ESE Rendering Solutions Limited was incorporated on 26 March 2015 as a plastering and rendering contractor. It was registered as an employer and contractor for CIS purposes on 14 April 2015. It has two directors, one of whom was Katie Langton.

The Notice of Appeal, dated 26 September 2017, sought to challenge 34 separate penalties, totalling £6,900, imposed by HMRC on the company for the late filing of Forms CIS 300 for a succession of periods from August 2015 to January 2017.

HMRC stated that:

"The penalty notices were issued to the Appellant and their representative on the dates detailed to the addresses held on record. None of the notices were returned as undelivered."

However, the company claimed that they had not received any penalty notices.

On 7 September 2017, HMRC sent a letter setting out all the penalties said to have been issued but there was nothing in that letter to substantiate the source of the information. Moreover, the table did not match the table in the Statement of Case, and there was no evidentially admissible explanation for the inconsistencies.

At the hearing, the company produced two letters from Debt Management dated 16 December 2016 and 23 January 2017 respectively relating to a CIS Fixed Penalty of £200 for the period ended 5 August 2016 and a CIS Fixed Penalty of £100 for the period ended 5 October 2016.

Both letters were headed 'Construction Industry Scheme amount due' and had a schedule headed 'Statement of Liabilities'. However, neither letter referred to anything other than the £200 for August 2016, and £100 for October 2016.

Decision

The Tribunal did not understand why, if HMRC was owed money in relation to other penalties, why those were not mentioned in the two letters produced as evidence and so were not apparently being pursued.

As no other documentary evidence was produced by HMRC to support earlier penalties, the Tribunal concluded that there was no evidence before 16 December 2016 of any penalties being issued at all and so the earlier penalties were discharged.

The Tribunal found that HMRC did give notice of the remaining two fixed penalties (August and October 2016), However, since the £200 penalty for the period ending 5 August 2016 did not appear in HMRC's Schedule of amounts payable, this penalty was also discharged.

The Tribunal were satisfied that the one remaining fixed penalty of £100 for the period October 2016 was valid. The company had been made aware of it, through its accountants, in December 2016. The monthly return for that period was due by no later than 19 October 2016, but was not received (as part of a batch of returns) until 29 June 2017.

ESE Rendering Solutions Limited v HMRC (TC07137)

Partnership losses and dissolution (Lecture B1141 – 17.36 minutes)

Summary – The taxpayer’s draft accounts did not contain any analysis that could justify the current year loss claim, which meant that the losses claimed as carried forward to subsequent years were also disallowed.

From 14 April 2004 Douglas Shanks LLP carried on the profession of accountancy with two members: Douglas Shanks and Celestial Accounting Limited, a dormant company. On 30 June 2008, Mr Shanks ceased practicing with the LLP and he became a partner in a series of other LLPs.

His 2008/09 tax return included partnership pages for the LLP where he claimed a current period loss of £221,667 and carried forward other losses of £235,298.

His 2008/09 and later returns contained no partnership pages for his share of profits from the new LLPs that he was involved with but instead self-employment pages where he reported the profits that he was entitled to. In the white space of these returns he wrote that throughout, his income should be treated as from one profession, and that his trade had continued throughout.

Douglas Shanks LLP was dissolved on 13 October 2009. Mr Shanks claimed deductions for the brought forward losses sustained in Douglas Shanks LLP against his income in the tax years 2009/10 and 2010/11. He argued that he had a single source of consultancy income throughout his professional career, providing the same services to a continuing and consistent body of clients. Losses sustained in earlier years could be carried forward and offset against profits in later years.

HMRC disagreed arguing that the loss relief claim for 2008/09 was not allowable. The deadline filing date for the Douglas Shanks LLP partnership tax return was 31 January 2010 and any amendment needed to be made by 31 January 2011. The amended 2008/09 return was not filed until filed 11 October 2012 and so was out of time and filed about three years after the LLP had been dissolved. Draft accounts of the LLP were not filed until 11 September 2014 – around five years after dissolution, and around two years after the amended tax return was filed. No finalised accounts were submitted – probably because, having been dissolved in 2009, there was no legal entity in existence to finalise financial statement. For all these reasons the purported losses were unsubstantiated.

Additionally HMRC argued that the losses could not be carried forward against the profits of other LLPs. Douglas Shanks LLP was separate from that of the other partnerships. Therefore any losses from the former could not be carried forward against profits from the latter.

Douglas Shanks appealed.

Decision

The First Tier Tribunal rejected HMRC’s argument that the dissolution of a firm before the filing of a partnership return reporting the results of its actual trade disqualified Douglas Shanks from reporting the results of his notional trade.

However, the Tribunal acknowledged that he had only provided draft accounts and that these did not contain any analysis that could justify the loss claim. It therefore dismissed the appeal against the 2008/09 closure notice. This meant that the losses claimed as carried forward to subsequent years were also unsustainable, so that the appeals against the 2009/10 and 2010/11 closure notices also failed.

The Tribunal found that Mr Shanks was a partner in a succession of partnerships that meant that the basis on which he had reported his income in those returns was incorrect. However, the inaccuracy was not deliberate. He had taken a view and followed it accurately in all his returns, explaining it in the white space. He had not been careless; he had taken considerable care when reporting the information, including white space statements in his returns. No inaccuracy penalty was therefore due.

Mr Douglas Shanks v HMRC (TC07118)

Company residence

In the case involving Development Securities and others the UT reversed the FTT's decision and found that subsidiaries set up in Jersey, for the purpose of a tax avoidance scheme, were resident there.

A group of companies had implemented a scheme designed to crystallise latent capital losses and it was essential to the success of the planning that the appellant companies were resident in Jersey and not the UK in the relevant period. The issue was therefore whether the Jersey companies had been UK tax resident in that period. The Jersey-incorporated companies were wholly owned subsidiaries of a UK incorporated company (Development Securities Plc) and the case looked at the test of central management and control.

The FTT noted that the only business of the Jersey companies was to acquire assets under call option arrangements and they concluded that because the transactions were disadvantageous to the companies they were therefore not in the best interest of those companies. The FTT decided that the companies were only undertaking the transactions because the parent wanted them to do so and therefore control was in the UK.

The UT overturned the FTT decision noting that it was untenable given the facts of the case and was a misunderstanding of the nature of the transactions and the duties of the Jersey directors.

Commerciality of the transactions

The UT found that the Jersey companies had not acquired assets on uncommercial terms, 'in the sense that they were economically disadvantaged'. Whilst the relevant assets were acquired at an overvalue, the overpayment by the Jersey companies was not funded by them, it was funded by a capital contribution from their sole shareholder.

Duties of the directors

The UT noted that the duty of the Jersey companies' directors was to act in the best interest of the shareholders, employees and creditors. As the companies had no employees or creditors the duty of the directors was therefore to protect the interests of the shareholder.

Having reviewed the capital loss scheme in detail, including the uncommercial nature of the options, the Jersey directors did conclude that the transactions were in the best interests of the shareholder and therefore in the best interests of the company. The FTT, erroneously, took the view that because the transactions were uncommercial, they had to be contrary to the interests of the Jersey companies. The UT noted that this conclusion did not follow the reasoning and undermined the FTT's decision.

Another basis for the FTT conclusion was that they considered that the Jersey directors did not give sufficient consideration to the transactions but the UT found that this did not match up with the facts. They highlighted that board meetings had lasted several hours, the directors took advice from advisors, queried the stamp duty position and noticed inconsistencies in the paperwork, all indicating that due consideration had taken place.

Development Securities and others v HMRC [2019] UKUT 169

Contributed by Joanne Houghton

Permanent Establishments (Lecture B1143 – 8.44 minutes)

A non-UK resident company has hitherto only been liable to corporation tax if it carries on:

- a trade of dealing in or developing UK land; or
- any other trade through a permanent establishment in the UK (S5(2) CTA 2009).

However, this test is being widened next year following the enactment of S17 and Sch 5 FA 2019 – see the chapter entitled 'Non-UK resident companies carrying on UK property businesses'.

In this chapter, we are concerned with the meaning of the term 'permanent establishment'. S1141 CTA 2010 states that a non-UK resident company has a permanent establishment in the UK if (and only if):

- it has a fixed place of business here through which its business is wholly or partly carried on; or
- an agent acting for the company has authority to operate here on its behalf (and regularly does so).

Certain preparatory or auxiliary low-value activities such as storing or displaying the company's products, purchasing goods or merchandise and collecting information for the company are classed as exempt activities and do not therefore create a permanent establishment (S1143 CTA 2010).

It is known that some non-UK resident companies have artificially fragmented their activities in order to take advantage of this let-out and, in doing so, have avoided forming a permanent establishment.

With effect from 1 January 2019, a non-UK resident company is denied the permanent establishment exemption in S1143 CTA 2010 where that:

- that company (or group) carries on a business operation in the UK;
- that company (or one of the other group members) effectively has a permanent establishment where complementary functions are carried on; and
- those activities would create a permanent establishment if they all took place within a single company (S21 FA 2019).

This legislative change puts into UK domestic law part of the OECD and G20 programme to tackle the erosion of the tax base by multinational companies.

Contributed by Robert Jamieson

Topic review: intangibles for companies (Lecture B1142 – 17.43 minutes)

The treatment of intangibles by companies has seen several changes over the past few years especially in relation to goodwill and other customer related assets. This summary reviews the areas that have changed and also looks at some aspects of the intangible legislation where queries can arise.

Types of intangibles

The legislation defines an intangible asset as having the meaning that it has for accounting purposes and including internally-generated intangible assets and intellectual property.

'Intellectual property' is then specifically defined to mean any:

- patent, trade mark, registered design, copyright or design right, plant breeders' rights or rights under section 7 of the Plant Varieties Act 1997;
- right under the law of a country or territory outside the United Kingdom corresponding or similar to a right within the above bullet;
- information or technique not protected by a right within the first two bullets but having industrial, commercial or other economic value, or
- licence or other right in respect of anything within the preceding bullets.

Goodwill, including internally generated goodwill, is also included within the definition of intangibles but then the legislation notes that this is subject to any indication to the contrary – these contrary indications are set out in more detail below.

Accounting for intangibles

As the legislation is based on the treatment of intangible assets in the accounts of the company it is worth looking at the accounting treatment of intangibles under different accounting standards.

There are essentially three broad categories of intangible assets:

- those that are separately acquired;
- those that are internally generated, and
- those that are acquired as part of the acquisition of a business combination (which include goodwill).

Intangibles that are separately acquired will generally satisfy the recognition tests in UK and international accounting standards and will be recognised at cost.

Internally generated intangibles cannot be recognised as assets under FRS 105 and only in limited circumstances under FRS 102 and international accounting standards.

The last category, intangible assets acquired as apart of a business combination are included in the goodwill arising on acquisition under FRS 105. FRS 102 and international accounting standards allow their separate recognition where the fair values can be measured with sufficient reliability and then they are recognised at fair value.

Negative goodwill, that is where the fair value of the assets and liabilities acquired on a business combination is greater than the cost of the acquisition is recognised as a credit on the balance sheet under FRS 102 and FRS 105 but under international accounting standards it is credited to profit and loss.

It is important therefore on a business combination to ensure that the breakdown of intangible assets is fully reviewed to establish any that can be recognised separately from goodwill. If these assets are not restricted under the rules for goodwill and other customer related assets, then relief for any amortisation may be available.

Partnerships and intangibles

Another area where the accounting can have an impact on the treatment of intangibles is for partnerships. The corporate intangible regime does not have specific rules on partnerships that hold intangibles but on general principles it would be assumed that the look through approach would be taken to determine the profits and losses to be apportioned to a corporate partner.

However, the accounting treatment can impact on this as the company accounts may show the holding in the partnership as an investment (as in the case of an LLP) rather than the company's share of the underlying assets including intangible assets. In *Armajaro Holdings Ltd* [2013] UKFTT 571 (TC) it was found as the company showed the holding in the partnership as an investment it was not entitled to a deduction for the amortisation.

For a discussion of the treatment of partnerships and intangibles see 'Encountering intangibles: some practical suggestions' by Gregory Price in *Tax Journal* 16 May 2018.

Goodwill and customer related assets – restrictions on debits

When the corporate intangible regime was first introduced in 2002 there was no restriction on the debits relating to goodwill and other customer related intangibles. However, HMRC felt that the regime was too generous to allow relief for goodwill in the company following incorporation of a sole trade or partnership together with entrepreneur's relief on the incorporation gain at 10% so they introduced restrictions on the debits allowed.

Specific types of assets are covered and these are:

- goodwill in a business or part of a business;
- information which relates to customers or potential customers of a business or part of a business;
- a relationship (whether contractual or not) between a person carrying on a business and one or more customers of that business or part of that business;
- an unregistered trademark or other sign used in the course of a business;
- a licence or other right in respect of any of the above assets.

The restrictions have changed over time and are summarised in the table below.

Date	Summary of treatment of goodwill and other customer related assets
Acquired or created on or after 1 April 2019	Relief only available if acquisition includes qualifying intellectual property (IP), fixed at 6.5%, restricted to 6 x qualifying IP acquired
Acquired or created on or after 8 July 2015 and before 1 April 2019	No relief under the post 2019 rules if acquisition between 8 July 2015 to 31 March 2019
Acquired or created on or after 3 December 2014 and before 8 July 2015	No relief where the acquisition was from a related individual or partnership
Acquired on or after 1 April 2002 and before 3 December 2014	Relief for debits in relation to the assets or at fixed rate if election made

So, when the intangible asset is acquired is key to the tax treatment for debits along with who the acquisition was from i.e. a related or a third party. The debits are not lost altogether but will only be available as non-trading debits on realisation of the asset.

In summary the rules for current acquisitions are that relief is at a fixed rate of 6.5% of the cost of the asset and the amount of relief may be partially restricted if the expenditure on qualifying IP multiplied by six is less than the expenditure on goodwill or customer-related asset.

Qualifying IP assets means a:

- patent
- registered design
- copyright or design right
- plant breeders' right
- right under

If goodwill or a customer-related intangible asset is transferred to the company, on or after 1 April 2019, from a related individual or from a partnership where a partner is related to the company, then relief is only available if that asset was acquired in a third party acquisition by the transferor and is transferred to the company along with the business.

The relief is again at a fixed rate of 6.5% and will only be available when there is a business acquisition that includes the acquisition of qualifying IP. The relief may be proportionately restricted to the notional accounting value of the goodwill or customer-related asset. Interestingly as detailed above FRS 105 does not allow the recognition of separate intangibles so the accounting treatment may be relevant here.

Acquisition or creation of goodwill

As a general rule, an intangible asset is treated as acquired or created on or after 1 April 2002 to the extent that expenditure on its acquisition or creation is incurred on or after that date.

The most notable exception to the general rule on when an asset is created or acquired relates to goodwill.

The general rule continues to apply in the following situations:

- where the goodwill is acquired by a company on or after 1 April 2002 from a person that is not a related party in relation to the company;
- where the goodwill is acquired by a company from a person that is a related party but is also a company, in respect of which the goodwill is goodwill that is already within the corporate intangible regime; and
- where the goodwill is acquired by a company from an intermediate person, who acquired it on or after 1 April 2002 from a qualifying third person.

In any other circumstances it will be necessary to consider when the goodwill was created; either by the company itself or by a related party from whom the company acquires the goodwill.

Where the business to which the goodwill relates was carried on, either by the company concerned or a related party (considered at the time the goodwill is acquired by the company), at any time before 1 April 2002, it is deemed to have been created before 1 April 2002. In any other situation it is deemed to have been created on or after 1 April 2002.

Although the intangible rules have been in place for a long time now this is always an area to watch on incorporation of a business and also any subsequent sale of the company as pre-2002 goodwill will fall within the rules for chargeable assets.

De-grouping changes on intangibles

There were also some recent changes to the de-grouping rules for intangibles. Where a company ceases to be a member of a group on or after 7 November 2018, a degrouping charge will not arise where the company leaves the group as a result of a share disposal by another company where that share disposal qualifies for the substantial shareholding exemption (SSE). This is as long as the disposal of share is not an arrangement under which the recipient is to dispose of the shares to another person.

The treatment of intangible assets when a degrouping charge arises as a result of a share disposal is therefore now similar to the treatment of assets under the chargeable gains regime but the difference is that with chargeable gains assets the degrouping charge accrues but can be relieved by available exemptions and reliefs such as SSE. The company acquiring the asset therefore effectively realises a market value uplift without a tax charge. The treatment for intangible assets is that the deemed realisation and reacquisition at market value is viewed as having not taken place and the transfer of the asset remains on a tax neutral basis.

For an examination of intangible assets and hive downs see 'Hive downs' by James Tryfonos in Tax Adviser on 1 May 2019.

Contributed by Joanne Houghton

Offshore receipts in respect of the digital economy

From 6 April 2019, unless an exemption applies, a person is subject to an income tax charge of 20% if they are not resident in the UK or a full treaty territory and UK-derived amounts arise to them in the tax year.

A UK-derived amount is an amount (whether capital or revenue in nature) made in respect of the enjoyment or exercise of intangible property rights where the enjoyment or exercise of those rights (or rights derived directly or indirectly from those rights) enables, facilitates or promotes UK sales.

'UK sales' means any services, goods or other property either provided in the UK, or to persons in the UK.

The legislation which effected the charge to income tax was introduced in FA 2019 and this allowed for subsequent regulations to be made to deal with any required amendments. HMRC have issued draft regulations and is consulting on these until 19 July 2019 but some of the amendments will have effect for 2019/20 tax year.

The changes applying to income arising from 6 April 2019 are summarised as follows:

- for determining UK sales, resellers will be looked through and the provision of online advertising services will be a UK sale to the extent that the advertising is targeted at persons in the UK;
- a new exemption for persons in specific territories with which the UK does not have a tax treaty, the territories will be listed in further regulations but are likely to be high tax jurisdictions;
- a new exemption for amounts derived from third party UK sales where the intangible property makes an insignificant contribution to the sale, allowing a reduction in administrative burden in tracing sales; and
- a new exemption to ensure that two companies in a group cannot be subject to a double charge on the same income.

Amendment which will only apply to amounts arising after the regulations come into effect are as follows:

- an extension to the scope of the income tax charge to low tax jurisdictions in circumstances where the non-UK person is resident in a jurisdiction with which the UK has an appropriate double taxation agreement but where the provisions of the agreement mean that there is no tax relief available to the person. This may be because the person (or the income) is excluded under the terms of the double taxation agreement;
- entities that are resident in a full treaty territory but only liable to tax there on a source or remittance basis remain within the scope of the income tax charge; and
- a new exemption where UK-derived amounts arising to certain partnerships are fully taxable at a partnership level which ensures that an income tax charge under these provisions does not apply in respect of the same UK-derived amounts at the level of the partners where the partnership is chargeable in a full treaty territory on the amounts.

It is intended that the regulations will be formalised in Autumn 2019.

www.gov.uk/government/consultations/draft-regulations-offshore-receipts-in-respect-of-intangible-property

Contributed by Joanne Houghton

OECD workplan for the digital economy

Following the publication of its policy note in January 2019, the OECD has now set out the programme of work to reach an agreement on an international approach to the taxation of the digital economy. The aim is to reach consensus by the end of 2020.

The plan will focus on the two main 'pillars' which were set out in the policy document.

The first pillar covers where and on what basis tax should be paid (nexus rules), and the proportion of profits to be taxed where users are located (profit allocation rules).

The second involves a system to protect against profit shifting to low-tax jurisdictions (BEPS issues).

The programme also notes that the treatment of losses will be considered and a new nexus rule which would apply where a multinational has 'a remote but sustained and significant involvement in the economy of a market jurisdiction' rather than a physical presence.

As the taxing rights of a group's profits may be based on a proportion of profits rather than a specific transaction or the activities of an entity the process of double tax relief will be reviewed as part of the work and whether existing treaty provisions would be effective. Alongside this, administration and collection procedures for taxing profits would also have to be reviewed.

The pillar two work will review two inter-related rules: an 'income inclusion rule' that would tax the income of a foreign branch or a controlled entity if that income was subject to tax at an effective rate that is below a minimum rate and a 'tax on base eroding payments' that would operate by way of a denial of a deduction or imposition of source-based taxation (including withholding tax), together with any necessary changes to double tax treaties, for certain payments unless that payment was subject to tax at or above a minimum rate.

Programme of work to develop a consensus solution to the tax challenges arising from the digitalisation of the economy

Contributed by Joanne Houghton

VAT

Ceroc dancing (Lecture B1141 – 17.36 minutes)

Summary - The teaching of Ceroc dancing was not purely recreational and fell within the education exemption.

Anna Cook had taught Ceroc dancing classes under a franchise agreement with Ceroc Enterprises. The teaching of Ceroc uses a form of pairs dancing that incorporates moves from many other styles of dance (ballroom, salsa, jive, hip hop and tango), and involves a particular methodology for learning those moves.

She had neither registered for VAT, nor paid any VAT.

The issue was whether her tuition fell within the education exemption Sch 9 Group 6 Item 2 VATA 1994 as 'the supply of private tuition, in a subject ordinarily taught in a school or university'.

Decision

Referring to Haderer (Case C-445/05), the First Tier Tribunal noted that the exemption is not limited to education which leads to examinations for the purpose of obtaining qualifications, or which provides training for the purpose of carrying out a professional trade. It includes other activities, provided that those activities are not purely recreational.

As dance was a subject ordinarily taught in schools, the first question was whether teaching Ceroc dance was the same as teaching dance. On the basis that Ceroc involves at least 500 moves and is a methodology to teach dance, the First Tier Tribunal found that teaching Ceroc was the same as teaching dance.

The Tribunal also found that Ceroc was not purely recreational, as classes involved the transfer of knowledge and skills from teacher to pupil. They included an educational content.

The appeal was allowed.

Anna Cook v HMRC (TC07149)

Adapted from Tax Journal (7 June 2019)

Registration and the Flat Rate Scheme (Lecture B1141 – 17.36 minutes)

Summary – The First Tier Tribunal lacked jurisdiction to vary the 9.5% FRS rate used to calculate the VAT liability and HMCR's assessment. However, given the circumstances, the Tribunal asked HMRC to consider allowing the taxpayer to withdraw retrospectively from the scheme.

Peter Hartigan had been self-employed since 2005/06, repairing and fitting gates. He undertook no new-build housing work.

Despite his online accounting system showing turnover of £89,635 for the year to 31 March 2015, Mr Hartigan had never been VAT registered. On 9 December 2015, HMRC wrote to Mr Hartigan to request details of his income and expenditure and a copy of his bank statements. There followed responses from Mr Hartigan in December 2015 and January 2016, giving the requested information to cover the period from April 2011 to March 2014.

From HMRC's schedule listing the actual monthly sales from April 2011 onwards, Mr Hartigan's rolling 12-month turnover was at £78,486.50 by October 2012, when the registration threshold stood at £77,000, making The Effective Date of Registration ('EDR') 1 December 2012.

Mr Hartigan claimed he had never been advised to register for VAT by his accountant. He knew little about tax and when asked of his understanding of VAT, he said that he believed VAT was to be taken into account when profit (not turnover) was over a certain threshold and that he had never charged VAT on his jobs. This was why he had engaged the service of an independent accountant, Alan Henderson, to undertake his accounting and tax work.

Later he engaged a second accountant, Tom Murray, who advised Mr Hartigan to join the flat rate scheme with retrospective effect from December 2012, applying a 9.5% flat rate that was relevant to his business.

HMRC calculated that tax of £21,335 was due for the period from 1 December 2012 to 31 March 2015 and assessed this amount. Mr Hartigan appealed.

Decision

The First Tier Tribunal concluded that Mr Hartigan had been let down by his accountants.

The first had not dealt with his client's VAT registration, despite the fact that his self-assessment returns clearly showed income that breached the threshold for over two years. The Tribunal added that it was unfortunate that Mr Hartigan had not been advised to make labour-only supplies, and to arrange for his customers to be invoiced directly by the suppliers for the materials, especially for the high-value items from catalogues. If he had been so advised, then his invoiced totals would not have pushed him over the VAT registration threshold in force for the relevant periods. The Tribunal had much sympathy for the taxpayer but stated that they can only apply the law to the facts of the case. There is no dispute that the income meant that the VAT registration threshold was breached by the end of October 2012, making registration compulsory as from 1 December 2012. This is the material fact.

The second accountant had ill-advised him to join the Flat Rate Scheme. The Tribunal highlighted that the VAT due of £21,335 was some 40% higher than it would have been had he remained outside the Flat Rate Scheme. However, the Tribunal lacked jurisdiction to vary the 9.5% Flat Rate Scheme rate used to calculate the VAT liability. Unfortunately, HMRC does not allow a retrospective Flat Rate Scheme withdrawal just because more tax has been paid. It followed therefore that they no other option but to confirm the VAT assessment for the period from 1 December 2012 to 31 March 2015 in the sum of £21,334.

However, in summing up, the Tribunal encouraged HMRC to allow Mr Hartigan to withdraw from the FRS back to 2012 in view of the exceptional circumstances, and to recalculate his liability accordingly.

Peter Hartigan T/A Striking Iron V HMRC (TC07109)

Production costs – direct + immediate link (Lecture B1141 – 17.36 minutes)

Summary – Residual VAT recovery was possible relating to taxable supplies with a direct link to production costs. These included catering, recording sales and certain production specific events. Other disputed supplies were denied.

The Royal Opera House Covent Garden, home of The Royal Opera, The Royal Ballet and The Orchestra of the Royal Opera House, produces internationally acclaimed opera and ballet.

Although as a charity the Royal Opera House does not expect to make a profit, the income from catering and retail sales, in addition to box office receipts and funding from Arts Council England, was required to support its artistic output. A visit to the Royal Opera House begins when booking a ticket on the website, but is extended to include the opportunity to reserve a table in the restaurant for the entire evening, purchase champagne, ice cream and programme vouchers. In addition, unlike the restaurants and bars, which were the preserve of ticket holders only, the shop was open to the public from 10am on Mondays to Saturdays and most evenings closed either at curtain, which was shortly after 7:30pm, or when there was not a performance at 6:00pm.

Tickets bought to see an opera or ballet are exempt from VAT under Group 13 Schedule 9 VATA 1994 (cultural services etc). The Royal Opera House also makes a number of taxable supplies such as catering, programme sales and production specific commercial sponsorship. With the Royal Opera House making both taxable and exempt supplies, the business is a partially exempt trader and as such, should be able to recover input VAT to the extent that it relates to taxable supplies.

On 15 December 2017 HMRC denied a claim by the Royal Opera House to recover input tax of £532,069 associated with the cost of staging productions (the Production Costs) at the Opera House between 1 June 2011 and 31 August 2012. The Production Costs were costs related to each production and not the costs of the Royal Opera House permanent staff or its fixed overhead costs. These included the fees for guest performers and conductors, creative teams, music costs, the cost of sets, props, costumes, transportation, extras and actors.

The issue in this case is whether there is a direct and immediate link between the Production Costs and the following taxable supplies (the “Disputed Supplies”) made by the Royal Opera House:

- Catering income (bars and restaurants) and ice cream sales;
- Shop income;
- Commercial venue hire;
- Production work for other companies.

Decision

The Tribunal concluded that the opera or ballet is central to everything the Royal Opera House does. Taking an economically realistic view, purpose of the Production Costs was not solely for the productions of opera and ballet but also to enable the Royal Opera House to maintain its catering income. There was a direct and immediate link between Production Costs and the catering supplies in the bars and restaurants of the Opera House. The same applied to the sale of ice creams.

The Tribunal also concluded Production Costs do have a direct and immediate link to the sale of recordings, both audio and visual, of Royal Opera House productions. The same could not be said of the remaining supplies that the shop made which had no more than a commercial link.

The Tribunal considered that there was a direct and immediate link between the Production Costs and production specific events, such as a Gala Dinner in support of a production by a sponsor. But this was not the case for other commercial events such as the Wimbledon Champions Dinner. In such circumstances there was no connection or link with any specific production and input tax recovery was denied.

The Royal Opera House receives orders from other opera and ballet companies to construct scenery and make costumes. In the Tribunal's view, this was not a direct and immediate link with the Production Costs. This work was undertaken at a fixed price, which includes materials and labour, and as such the Production Costs could not be a cost component of these supplies.

In summary, there was a direct and immediate link between the Production Costs and the taxable catering supplies in the Royal Opera House's bars and restaurants, sales of ice cream, shop (including online) sales of recordings of Royal Opera House productions and production specific commercial venue hire. There was no such link in the case of the remaining Disputed Supplies.

Royal Opera House Covent Garden Foundation v HMRC (TC07157)

No VAT on payroll services (Lecture B1141 – 17.36 minutes)

Summary – A Payroll Service to support disabled persons constituted a “supply of services closely linked to welfare work” and a supply of “services which are directly connected with the provision of care” and so were exempt

Section 1 Care Act 2014 sets out the general responsibilities of local authorities relating to care and support for adults and states that local authorities should promote the well-being of disabled individuals which includes helping the person to take control over day-to-day life. Disabled persons often require help in order that they can remain in their home and live independently. The help that is needed is usually provided by a carer or Personal Assistant, who visits the disabled person in their own home and assists them with everyday tasks.

The individuals concerned may be eligible for financial assistance, in the form of a personal budget, from local authorities to assist with their identified care and support needs. This budget may be managed in a number of ways, but the governments preferred approach is by a direct payment being made to the disabled person or their representative (“Direct Payments”). Direct Payments enable the disabled person to take control of and pay for their own support/health and wellbeing services, thus enabling them to live independently in their own homes.

Unfortunately, employing a carer requires the disabled person to act as an employer of the Personal Assistant, which entails legal and administrative requirements, including payroll and all that that entails

Cheshire Centre for Independent Living is a charity that provides a range of support services for disabled people, their families and carers. One of the services that they provide is such a Payroll Service.

On 11 January 2013 HMRC ruled that the Payroll Service supplied to the individual was standard rated for VAT, and did not qualify for the welfare services exemption in item 9 group 7 sch 9 VAT Act 1994. HMRC argued that the Payroll Service was one step removed from the actual care received by the recipient of care. The supplies related to the administration of the Direct Payments necessary to fund the care – and not to the actual care itself.

Cheshire Centre for Independent Living appealed. They argued that Direct Payments are an intrinsic feature of independent living. They are the means by which disabled people are able to purchase the support they need to be able to go to work, support their families and engage in everyday activities. Their object is to give vulnerable people control over the services they receive, enabling them to live independently in their own homes. The related payroll services are connected and so should be exempt from VAT.

Decision

The First Tier Tribunal stated that this type of Payroll Service must be viewed in the context of its provision to the recipients of Direct Payments, rather than by comparison with employers generally who may choose to engage a payroll bureau.

The First tier Tribunal stated that the dispute concerned whether the Payroll Service constitutes a “supply of services closely linked to welfare work” for art 132(1)(g) of the Principal VAT Directive, and a supply of “services which are directly connected with the provision of care” for item 9. The First Tier Tribunal concluded that to be exempt the payroll service needed to be closely linked to a principal exempt supply.

Without the Payroll Service, many disabled persons would have to forego taking a Personal Assistant as they could not cope with the employer responsibilities. This would contradict the Department of Health’s objective that disabled people should take ownership of their care planning.

The appeal was allowed.

Cheshire Centre for Independent Living v HMRC (TC07182)

VAT zero-rating for transport of disabled passengers

Revenue & Customs Brief 3/2019 clarifies that HMRC has not changed its policy on the scope of the VAT zero rate for transport services following the Upper Tribunal decision in *Jigsaw Medical Services Limited*.

Broadly, the position remains that if a vehicle would seat 10 or more passengers, were it not for adaptations made to accommodate wheelchair users, the supply of passenger transport in such a vehicle is zero-rated.

The Jigsaw case

This case considered whether transport in certain types of 'blue light' emergency ambulances was zero rated for VAT. The Upper Tribunal decided that it was not zero-rated.

HMRC's policy

Exempt supply: The supply of transport services for sick or injured persons in vehicles specially designed for that purpose.

Zero-rated supply: The supply of passenger transport if the vehicle used meets certain seating criteria.

Seating criteria

The supply of transport in any vehicle with seating to carry 10 or more passengers (including the driver) is a zero-rated supply.

Where a vehicle is designed or adapted to safely carry one or more persons in a wheelchair and, if it were not for those changes alone, the vehicle would seat 10 or more passengers, it is also a zero-rated supply.

Exempt and zero rated

It is possible for a vehicle designed to carry sick or injured persons to also meet the seating criteria. The transport of sick or injured people in such a vehicle would therefore meet the criteria for both VAT exemption and zero rating. In these cases the zero rate would take precedence.

Not all vehicles designed to carry sick or injured people will meet the seating criteria, so transport of passengers in these vehicles is not zero rated.

How to decide if a vehicle can carry 10 or more people

This must be considered by reference to the actual and anticipated ways in which the vehicle is or will be used. Simply demonstrating that 10 seats can fit in a vehicle is insufficient to apply the zero-rating. To meet the seating criteria, the seats must also be usable in a sensible way and in acceptable circumstances. The vehicle must meet the seating criteria at the time the supply of transport takes place.

Adapted for wheelchairs

The zero-rate includes the transport of passengers in a vehicle designed or substantially and permanently adapted for the safe carriage of a person in a wheelchair or, 2 or more such persons and which, if it were not so designed or adapted would be capable of carrying no less than 10 persons.

The adaptations for wheelchairs rule allows transport, in vehicles that otherwise would have 10 seats, to be zero-rated. Transport in a vehicle with less than 10 seats is not intended to be zero rated on the basis that the vehicle could be redesigned to have at least 10 seats.

The Jigsaw decision sets out the following approach:

1. Identify what was done to the vehicle to design it or adapt it for the safe carriage of a person in a wheelchair;
2. If the wheelchair modifications were not made, what extra passenger capacity could be added?

What is not allowed, is to presume what other changes could be made to increase the number of seats. That is inconsistent with the rule that looks at the vehicle as it is and how the vehicle is being used.

<https://www.gov.uk/government/publications/revenue-and-customs-brief-3-2019-vat-zero-rating-of-transport-of-disabled-passengers/revenue-and-customs-brief-3-2019-vat-zero-rating-of-transport-of-disabled-passengers>

Domestic reverse charge if trading in renewable energy certificates

Renewable energy certificates are certificates that are issued to gas and electricity generators when they produce energy from renewable means. These certificates can also be bought and sold as a commodity attracting others into the market which creates an opportunity for fraud.

They are commonly called Guarantees of Origin (GoOs) and are also known as Renewable Energy Certificates (RECS), Renewable Obligation Certificates (ROCS), Renewable Energy Guarantee of Origin (REGO) and International Renewable Energy Certificates (I-RECS).

From 14 June 2019, there will be a domestic reverse charge for supplies of gas and electricity certificates in the UK. This is to prevent the threat of missing trader intra-community fraud when these certificates are traded.

Revenue & Customs Brief 4/2019 provides guidance on how the domestic reverse charge will operate and should be read with Notice 735: VAT domestic reverse charge on specified goods and services.

How the reverse charge will work

The reverse charge will operate in the normal way meaning that a UK customer receiving supplies of renewable energy certificates must account for the VAT due on these supplies on their VAT return rather than the UK supplier. The customer then also deducts the VAT due on the supplies as input tax, meaning no net tax is payable to HMRC, subject to the normal rules for reclaiming VAT. This removes the opportunity for fraudsters to steal the VAT due to HMRC and follows

Suppliers of goods or services under the domestic reverse charge must not enter in box 1 of the VAT return any output tax on sales to which the domestic reverse charge applies. Suppliers must enter the value of such sales in box 6.

Customers must fill in box 1 of the VAT return the output tax on purchases to which the domestic reverse charge applies. They must not enter the value of such purchases in box 6. They must reclaim the input tax on their domestic reverse charge purchases in box 4 of the VAT return and include the value of the purchases in box 7, in the normal way.

When making a supply to which the domestic reverse charge applies, suppliers must:

- show all the information normally required to be shown on a VAT invoice;
- annotate the invoice to make clear that the domestic reverse charge applies and that the customer is required to account for the VAT.

The amount of VAT due under the domestic reverse charge should be clearly stated on the invoice but should not be included in the amount shown as total VAT charged.

Where a business' accounting system cannot show the amount of VAT to be accounted for under the reverse charge, then the wording should state that VAT is to be accounted for by the customer at the standard rate of VAT, based on the VAT-exclusive selling price for the reverse charge services.

Penalties

HMRC understands that this immediate change may be challenging and the difficulties businesses may have in implementing the domestic reverse charge. It will apply a light touch in dealing with errors that occur in the first six months after introduction.

HMRC officers may assess for errors during the light touch period, but penalties will only be considered if businesses are deliberately taking advantage of the measure by not accounting for it correctly.

www.gov.uk/government/publications/revenue-and-customs-brief-4-2019-vat-domestic-reverse-charge-for-businesses-trading-in-renewable-energy-certificates

Solving VAT problems with HMRC manuals (Lecture B1144 – 12.37 minutes)

Case study

What is your strategy for dealing with a VAT question asked by a client? To misquote Agatha Christie's fictional detective Hercule Poirot: "You must always have order and method in your ways."

Let us imagine the following situation: a client telephones you and asks about the VAT liability of providing a transport service to a hospital, which involves taking people from their private homes to their local hospital for treatment in his vehicle. He understands the fees he charges the hospital will be exempt from VAT but wants to be sure this is correct?

Stage 1 - the legislation

The starting point is to review the legislation, particularly Schedule 9 of the VATA1994, which comprises all of the different groups of goods and services that are exempt from VAT. And a good start to our query: Item 11 of Group 7 (Health and welfare) confirms exemption applies for "the supply of transport services for sick or injured persons in vehicles specially designed for that purpose"

Stage 2 – the public notices

Our imaginary client is encouraged by the above reference but is unsure about the meaning of the phrase 'specially designed' as far as his vehicle is concerned. He also wonders if a person who is in good health but has preventative treatment for a condition is classed as a 'sick or injured person'

The relevant public notice reference on this part of the legislation is VAT Notice 701/31, headed "Health institutions supplies," specifically para 2.7. And this is the next important point: always be clear that the public notices mainly provide HMRC's interpretation to the legislation, although some sections (not many) do have legal force. This interpretation takes into account the results of past tribunal cases. To quote directly from para 2.7:

"2.7 Transport supplied or received by a qualifying institution

Transport services are exempt when the:

transport is an integral part of the exempt supply of care and treatment provided by a qualifying institution

transportation, by any provider, of sick or injured persons to or from a place of medical care or treatment, in a vehicle specially designed or adapted for the purpose"

There is a problem here: the notice has not given any additional information that would help address our client's two concerns. The second bullet point is mainly repeating the words in the legislation. We need another source of information.

Stage 3 - HMRC VAT manuals

The VAT manuals are used by HMRC officers to deal with challenges in their day to day work. I have encountered situations where officers refuse to accept information in the public notices, instead preferring to quote and utilise the VAT manuals. It is very positive that they are available for us to as a public record, so we should take advantage of them where possible. And good news, the HMRC VAT manual on “VAT Health” has a very helpful policy note at VATHLT5030, which gives further detail about what HMRC considers to be a ‘specially designed’ vehicle, including detail about ramps and secure clamps for wheelchair users. And it also defines ‘sick or injured persons’ very clearly as ‘persons in need of or having just received medical care or treatment’

Note – some content in the HMRC manuals has been removed from public viewing on the basis that the department has claimed exemption within the Freedom of Information Act 2000. This content can still be seen by HMRC officers but not anyone outside of the department.

Search engines

You might be wondering how the above references can be found so easily. The challenge is to go to your favourite search engine and clearly enter “HMRC VAT manual” followed by the relevant topic eg “HMRC VAT manual transport services hospital patients.” I have just done this and it not only alerts me to VATHLT5030 which I quoted above but also VATHLT5040, which gives details of when exemption does not apply eg hospital services provided by a taxi firm would not qualify for exemption because taxis are not ‘specially designed’ vehicles.

Clear strategy

In the three-stage analysis above, I have not suggested either telephoning HMRC’s helpline service or writing to HMRC in Southend for a clearance letter. Putting aside the practical problems of getting to speak to someone in the modern world, my view is that a written audit trail to support a VAT outcome, such as the above analysis, gives much more legal certainty than a telephone call where issues could get confused with the interpretation of words, local accents or the use of jargon by the officer.

It is also important to recognise that HMRC will not ‘rubber stamp’ the VAT treatment of a particular deal. For example, builders sometimes tell their clients (wrongly) that they will only charge 0% or 5% VAT on a project if the customer gets written confirmation from HMRC that the lower VAT rate is correct. This is a flawed strategy – the builder should make his own decision on the VAT liability of his goods and services by consulting HMRC’s public notice 708 or the VAT manual on construction services. The days of a local VAT office giving VAT rulings on specific contracts are a long way in the past. So, as a final tip, don’t forget to copy and file the relevant HMRC information you use to solve a VAT dilemma, in case there is an HMRC query on a future compliance visit.

Contributed by Neil Warren

Disbursements – practical tips (Lecture B1145 – 12.34 minutes)

What is a disbursement?

The basic principle to consider is whether a charge to a customer relates to a recharge of the supplier's own expenses (e.g. his motor and travel costs) or is a cost that belongs to the customer i.e. a disbursement.

To give an easy example, when a solicitor deals with a house purchase on behalf of a client, he will often pay for expenses that belong to the client e.g. local authority search fees, Stamp Duty Land Tax, land registry fees. These expenses will eventually be paid for by the house buyer so they are clearly the buyer's expenses and not the solicitors. As long as the solicitor adopts certain procedures on his sales invoices, these disbursements will not be subject to VAT.

However, if a consultant based in Scotland does some work for a client in London, and the client agrees to pay her train fare, mileage expenses or hotel accommodation, this is not a disbursement situation – it is effectively an increase in her standard rated consultancy fee to cover her out of pocket expenses.

Key point – a recharge of expenses will follow the same VAT liability as the work being carried out i.e. standard rated in this case but outside the scope of VAT if her work had been for an overseas based customer (general B2B rule – place of supply is customer's country).

Example - architect charging expenses

Jane is an architect based in Manchester and she is registered for VAT as a sole trader. She is working on a property development in London and her client has agreed to pay for her rail travel, accommodation and photocopying costs as well as £30 per month for her telephone costs.

When Jane invoices the client, she will charge 20% VAT on all of these expenses, as they are her own business expenses and not those of the client.

Note - although the rail ticket will be zero-rated when purchased by Jane from the rail company, she will still charge 20% VAT on the recharge to the client because it forms part of her overall fee, just like the other expenses.

Reference: VAT Notice 700, para 25.1

Conditions for disbursements

Going back to the solicitor acting for a house buyer, he needs to be strict as far as his procedures are concerned to ensure there are no VAT problems in relation to disbursements charges:

He must ensure that all relevant costs belong to the buyer rather than his own business and he must have acted as an agent for the buyer when he paid the various third parties e.g. local authorities, land registry office etc.

The buyer must have received and used the goods or services provided by the third parties and the buyer was responsible for paying the third parties and authorised the payments to be made.

The payments must be itemised separately on the solicitor's invoice(s) and he will only recover the exact amount paid to the third parties.

HMRC VAT Notice 700, para 25.1.

As far as record-keeping is concerned, the business charging disbursements without adding VAT must be able to satisfy HMRC on two issues, if so requested:

Evidence of the actual payment made to the third party supplier, with a document confirming the detail and amount.

HMRC must be satisfied that no input tax has been claimed on the disbursement by the business recharging it to his customer. There might be scope for the final buyer to claim input tax (if the expense relates to taxable supplies etc) because the goods or services belong to that person or business.

Case law example - MoT testing fees

The priority is to ensure that a business only charges its customers the exact cost of a disbursement and does not apply a mark-up or profit margin. So if our solicitor pays £80 for a land registry fee but charges his client £100 on his sales invoice, HMRC will usually seek to assess tax on the £20 profit margin and, in some cases, the full £100 fee. It would not be a problem if he charged £80 as disbursement and then a separate fee of £20 for an administration charge – the latter would be standard rated but not the disbursement.

This was the problem in the case of *Ellon Car Clinic Ltd (TC5813)* concerning MoT recharges. The company was not licenced to carry out MoT tests on customers' vehicles, so subcontracted these tests to other garages, paying between £40 and £54.95 per test. It charged its customers a standard fee of £49.95 (no VAT), which HMRC assessed as being subject to 20% VAT i.e. the disbursement conditions had not been met. However, the tribunal supported the taxpayer on the basis that an agency arrangement was evident and the supply was clearly between the testing garage and the customer, a fact of which all parties were aware. The company was only subject to output tax on the profit margin i.e. for those tests that cost less than £49.95. No output tax was due on deals where the company made a loss.

VAT registration

It is important to note that the expenses recharged by an unregistered business form part of the 'taxable turnover' test for registration purposes. So, if a consultant has annual UK fees of £80,000 plus travel and hotel recharges to customers of £10,000, then his total taxable sales are £90,000 i.e. greater than the registration threshold of £85,000. This could be a big issue because HMRC has the power to backdate a late registration by up to twenty years.

Final challenge

If a business pays £100 + VAT for an overnight stay in a hotel, and this cost will be recharged to a customer, then it would be correct to charge £100 plus VAT to recover the cost incurred by the business, on the basis that input tax has been claimed on the hotel bill. But what about if the business uses the flat rate scheme and cannot claim input tax on the hotel bill? It might then be appropriate to charge the customer £120 + VAT to recover the cost. This issue is not a VAT problem – it is a commercial dilemma. As long as HMRC gets output tax on the amount charged (be it £100 or £120 + VAT), it will not be concerned how the figure was established.

Contributed by Neil Warren