

## Personal tax round up (Lecture P1256 – 21.38 mintes)

### Making the most of company pension contributions

The low salary/ high dividend extraction route adopted by many owner-managed businesses results in their own personal pensions contributions being restricted to their earned income. This is normally no more than the personal allowance.

It should be remembered that company pension contributions are not restricted to the individuals earned income and this is often an efficient way of increasing pension input. When you factor in the corporation tax relief on the company contribution this is a very efficient way of extracting profit from an owner managed business.

#### *Example*

Consider a company with £300,000 of pre-tax profit that makes a corporate pension contribution of £10,000.

The company currently obtains £1,900 of corporation tax relief, but this will increase to £2,500 if paid on or after 1 April 2023.

But what is the effective rate of extraction?

Once eligible to withdraw money from their pension fund at 55, the individual can withdraw 25% tax free i.e. £2,500 if we assume the fund value remains the same. The balance of £7,500 can be drawn down in retirement when the client is a basic rate taxpayer resulting in income tax of £1,500 on the £7,500. Overall the taxpayer will suffer £1,500 tax on a £10,000 extraction from their pension fund. An extraction rate of 15% is attractive but when we factor in the corporation tax relief of 19% we have a negative tax rate on profit extraction.

Going forward company pension contributions will become even more attractive as corporation tax rates increase.

#### *Deferring pension contributions?*

Consider a company that consistently pays £40,000 pa into the directors' pension fund.

Corporation tax relief is given when the pension contributions are paid so we could consider accruing director pension contributions in the years to 31 March 2022 and 2023 (to maintain a smooth effect on distributable profit each year) with a view to paying the accrued contributions in April 2023. The corporation tax relief from 1 April 2023 would be 25% when profits exceed £250,000 or 26.5% when profits are between £50,000 and £250,000. The extra corporation tax relief could be between £4,800 and £6,000 on £80,000 of contribution.

Although the individual loses the growth on £40,000 per annum, the company gets a guaranteed saving. It should also be noted that the growth is by no means guaranteed as pension funds can go up or down during this time.

Delaying the payment could also help companies that are cash poor at present.

### *Accruing contributions in the accounts*

To accrue £40,000 annual contributions in the accounts the company must follow the provisions of IFRS, FRS 102 or FRS 105.

These are all essentially the same and require:

- A legal or constructive obligation to make the contribution;
- That it must be probable that payment will be made, although timing can be variable; and
- A reliable measurement of the accrued amount can be made

It is the first condition that might cause problems. In practical terms, a specific clause in a contract of employment should suffice. For instance, the company would need to be obliged to pay a pre-agreed sum as a contribution, either as a fixed percentage of salary or fixed amount. The key is that it must not be in any way discretionary.

But most directors of family businesses do not have an employment contract. In these instances a pre year end board minute should suffice where the contribution is communicated to the director pre-year end.

*Contributed by Dean Wootten*

## **Enhanced protection late application**

*Summary – Relying on advice given, the taxpayer had a reasonable excuse and was allowed to claim an enhanced lifetime allowance for his pension despite applying late.*

In 2003, Maurice Gammell retired from his main role as managing director of Harry Ramsden, the fish-and-chip shop chain and seven years later he retired from all work.

In 2001, he had appointed financial advisors to advise on his pensions and investments but received no advice about enhanced protection in 2006 from those advisors or subsequently. When his named advisor changed in 2009 following illness, enhanced protection was still not brought to his attention. Further, he was not advised about the 2012 Fixed Protection Limit of £1.8m.

In August 2013, he was advised to apply for and received the 2014 Lifetime Allowance of £1.5m.

On 13 October 2015 a prospective new advisor alerted him to the failure to apply for:

- enhanced protection in 2009; and
- fixed protection in 2012.

Maurice Gammell took up the omissions with his existing advisors in December 2015, but by April 2016 he considered that there had been no progress in attempting to resolve the issue and so terminated their engagement.

Through his former advisor's complaints procedure, he was finally informed on 12 August 2016 that there was the possibility of applying for enhanced protection out of time. Maurice Gammell sought additional information which was provided by specialist consultants. The application was submitted on 19 December 2016.

It was not until 11 December 2018 that HMRC notified their decision to refuse the late application. HMRC accepted that Maurice Gammell had a reasonable excuse for the delay until 2015, but not for the 14-month gap that followed, leading up to the late application.

#### Decision

Problems with his professional advisers, including following their complaints procedure, constituted a reasonable excuse for that period. Maurice Gammell had acted promptly and reasonably once he had cause to believe that he faced serious unexpected problems. It was reasonable for him to rely on his existing advisors and engage in their complaints process.

The First Tier Tribunal accepted the late application.

The appeal was allowed.

*Mr Maurice Gammell v HMRC (TC08035)*

## **High income for child benefit charge**

*Summary – Although penalties were cancelled in respect of two tax years, they could not be cancelled for the third as by then the HMRC claim form was much clearer and the taxpayer had clearly breached the relevant limit.*

Jonathan Hayden was a member of the sales team of his employer and earned a base salary and bonus depending on sales.

In 2012/13 when the High Income Child Benefit Charge (HICBC) was introduced his earnings were £44,403 so below the £50,000 threshold for the charge to kick in.

HMRC's electronic record of correspondence indicates that in August 2013 Jonathan Hayden was sent a letter informing him of the new charge but he had no recollection of receiving it. He explained that had he received it, he would likely have paid it next to no attention as he was earning less than £50,000 a year at the time and he had a lot on his plate as his first child had just been born.

His wife claimed the child benefit allowance. He stated that if his wife had asked him about his salary before she made the claim, he would have said he did not have a salary in excess of £50,000. His taxable income was only more than £50,000 when his bonuses and car benefit were included and pension contributions are disregarded.

His base salary for each of the years 2014/15 and 2015/16 was below £50,000 but rose above that level in 2016/17.

HMRC claimed that they sent two letters to Jonathan Hayden regarding the HICBC. Firstly, a generic letter concerning liability to pay HICBC and what must be done to avoid a liability to penalty in respect of the year 2016/17, and then a "final reminder" letter sent on 30 October 2018.

Neither of these letters was received as his father, a former HMRC officer acting as his agent, had moved home but this change of address had not been notified to HMRC.

On 11 January 2019 HMRC wrote, advising Jonathan Hayden that he had a liability to pay HICBC in respect of the years 2014/15, 2015/16 and 2016/17.

Liability to pay the HICBC was accepted along with interest, but as Jonathan Hayden had no knowledge of the HICBC and HMRC had not been in touch with either him or his agent to raise an enquiry into any return, his father sought a reconsideration of any penalty and enclosed an article which had been published in a newspaper indicating that HMRC were undertaking a review of penalties imposed in 35,000 cases for failure to notify liability to HICBC where the taxpayers had received no prior notification of the charge.

The father could not understand why HMRC would write, as they say they did, in 2013 and not follow up within 30 days as they are required to do when making enquiries. To wait for more than four years to raise the issue of liability was extraordinary.

### *Decision*

The First Tier Tribunal noted that the HICBC was a novel form of tax. It was not income tax. Its operation could involve a charge to tax or a disclaimer of a benefit. Further, there had been misleading headlines and articles in the press.

The First Tier Tribunal accepted that Jonathan Hayden had a reasonable excuse for the first two years, 2014/15 and 2015/16, and cancelled the related penalties. The Tribunal accepted that the original claim form, completed after the birth of their first child in 2013/14, was unclear. Further, HMRC recognised that the need to file a Self Assessment return due to HICBC was possible only when taxpayers were aware of their obligations. The Tribunal concluded that it was unrealistic to expect employees with no other sources of income, where their employers were administering their tax, to be monitoring HMRC's website to see if there was a new obligation to file a return.

The Tribunal concluded that Jonathan Hayden did not have a reasonable excuse for 2016/17 as by then the form was more clearly written. The 2016 claim form, completed after the birth of their second child, stated that the claimant or their spouse must file a Self Assessment tax return where income of one of them exceeds £50,000, whereas the 2013 form spoke of the possibility that income may need to be declared. The Tribunal did not accept ignorance after the birth of his second child as a reasonable excuse in the light of the very clear statement in the notes to the 2016 Child Benefit claim form and the fact that Jonathan Hayden had changed jobs and his new base salary was in excess of £50,000 in 2016/17.

The appeal was allowed in part.

*Jonathan Hayden v HMRC (TC08037)*

## **Property losses and personal allowances**

*Summary – Property losses brought forward are set off against future property income prior to the deduction for a taxpayer's personal allowance.*

Sarah Duncan had realised some £16,000 of property losses in 2007/08, 2008/09 and 2012/13.

She made property profits as follows:

2009/10	£5,037
2010/11	£969
2011/12	£3,001
2013/14	£7,056
2014/15	£4,992
2015/16	£2,277
2016/17	<u>£2,132</u>
	<u>£25,464</u>

She submitted her 2017/18 tax return and included a claim to use a property loss brought forward of £6,017 from previous years. In February 2019 HMRC gave notice of an enquiry into this return, indicating that they were looking into the use of the losses.

On 28 June 2019 HMRC sent a revised tax calculation showing additional tax payable of just over £1,800, stating that all of the property losses previously realised had already been offset against property income in earlier years (S23 ITA 2007). A closure notice to that effect was issued a month later.

Sarah Duncan appealed, arguing that the correct approach was to use reliefs and allowances in such a manner as to maximise the benefit to the taxpayer. Adopting her approach, her property losses had not been used in prior years as the property profits were covered by her personal allowances. Relieving the losses in earlier years would have wasted her personal allowances.

#### *Decision*

The First Tier Tribunal agreed with HMRC.

Under s23 ITA 2007, the steps to follow when claiming relief must be followed in the order laid out in the legislation. Consequently, at step 2, the brought forward property losses should be deducted prior to the taxpayer's personal allowance, which is deductible at step 3.

The taxpayer's appeal was dismissed.

*Sarah Duncan v HMRC (TC08066)*

## **Goodwill versus trade related property**

*Summary - The valuation of property-based goodwill, where the profitability of two care homes was tied to the properties from which they were run, resulted in no SDLT being payable.*

Dr Zyrieda Denning acquired the freehold interest in Manor Place Nursing Home together with the business operating therefrom in April 2000 for £499,000. In March 2001, she also acquired the business operating from Maple House Nursing Home and subsequently bought the freehold interest in the property in June 2006 for £1m.

The care homes were initially operated by Dr Denning acting as a sole trader. Having set up companies, in 2011, Dr Denning transferred one care home to each company with an agreement that the transfers were transfers as going concerns in consideration including goodwill.

Retaining the freehold interest in both Manor Place and Maple House, Dr Denning granted leases over the properties with no premium payable. The leases were for 5 years at an annual rent (without review) of £225,000 for Manor Place and £175,000 for Maple House. Under RICS guidance the leasehold interests were valued at a combined £1,200,000.

Deeds of assignment of the goodwill of the businesses from Dr Denning to the companies were for consideration of £1,125,000 and £675,000 respectively.

HMRC argued that the value goodwill was inherent in the property, making it inseparable from the value of the leases. HMRC raised SDLT discovery assessments against the companies in respect of the lease interest acquisitions.

Dr Denning and the companies appealed against tax return amendments and the SDLT discovery assessments. The taxpayers sought to show that the law recognises goodwill as a separate asset, distinct from the land asset. If that is so, then a valuation made on the basis that the goodwill is part of the land asset would be wrong in law.

#### *Decision*

The Upper Tribunal stated that the agreed market rent fully reflected the trading potential available to the tenant under the terms of the 5-year lease.

The Tribunal were satisfied that the trading potential of both the Manor Place and Maple House care homes was reflected in the agreed valuations and so those valuations represented transferable property-based goodwill. The Tribunal found that, using RICS guidance, the value of the leasehold interest represented goodwill only, with no additional premium on the lease that could be subject to SDLT.

*Zyrieda Denning and others v HMRC ([2021] UKUT 76 (LC))*

## **Stale discovery**

*Summary – Discovery assessments issued four years after the start of an investigation and some three years after the taxpayer had admitted the inaccuracies were held to be stale.*

Kashif Mehrban owned and operated a small retail store selling newspapers and magazines, alcohol, tobacco products and other general household goods. He also operated a “Paypoint” and “Payzone” terminal (which allowed customers to make bill payments in store) and a national lottery terminal.

On 21 March 2013, HMRC made an unannounced visit to his shop to check the credibility of his VAT and income tax returns. In 2014, an investigation was initiated under COP 9 and Kashif Mehrban was informed that HMRC suspected that he had committed tax fraud and invited him to enter into a Contractual Disclosure Facility to avoid criminal prosecution by making a complete and accurate disclosure of all tax irregularities. He made a statement in November 2014 that he had understated taxable profits.

It then took until 2017 for HMRC to issue discovery assessments for 2002/03 to 2015/16. The total amount assessed was £176,513.39 plus penalties.

## *Decision*

The First Tier Tribunal found that HMRC had discovered that there had been an insufficiency in the tax charged at the very latest on or around 25 March 2014. By that time HMRC had:

- concluded that the gross daily takings were not being recorded on a daily basis, and that the numbers declared were not credible;
- conducted a cash-up exercise and carried out test purchases which revealed that sales appeared to be understated by about 70%; and
- concluded that purchases had been suppressed by around £18,811.64 over a three-month period.

It was at this time that HMRC had referred the case for investigation for fraud under the COP9 procedure.

The Tribunal then turned to the question of whether the discovery had become stale by the time that the assessments were made on 21 April 2017, over three years later.

The Tribunal asked the question what happens if HMRC makes an assessment which is wrong, leading to an underassessment of tax? The Tribunal concluded that delaying issuing their discovery assessment to ensure that they have the full information was missing the point. Where additional information later comes to light, HMRC would have discovered something new, so making a fresh discovery, enabling HMRC to make a further discovery assessment where objectively reasonable for them to do so.

Consequently, the Tribunal held that the significant delay of over 3 years between the discovery and the assessment had caused the discovery to become stale and the assessments were therefore invalid.

*Kashif Mehrban v HMRC (TC08039)*

## **No deliberate inaccuracy and no concept of staleness**

*Summary – There was no deliberate inaccuracy in the taxpayer’s return as he had made it clear what he had done and the tax position that he wanted to take.*

Mr Tooth entered into an arrangement known as “Romagate” in an attempt to obtain an employment loss. He had submitted his tax return, claiming the loss as a partnership loss, rather than an employment loss, before retrospective legislation was enacted that nullified the event.

He had informed HMRC in the "white space" to the return that the loss he claimed was an employment related loss but as his approved software did not allow to him to enter the loss as an employment loss, he had included the amount on his partnership pages.

HMRC issued a discovery assessment on Mr Tooth (after the enactment of the legislation which nullified the arrangement) on the basis that:

1. HMRC had discovered an insufficiency in Mr Tooth's return;
2. Mr Tooth's return contained an inaccuracy (in that the loss was entered on the partnership pages of the return and Mr Tooth's explanation as to why he had done this did not alter the nature of what HMRC consider to be an inaccuracy); and
3. This inaccuracy was deliberate.

The First Tier Tribunal found that although HMRC had made a discovery, there was no deliberate inaccuracy.

The Upper Tribunal agreed that there was no deliberate inaccuracy but found that the discovery had gone stale between 2009 when they said it was originally found and 2014 when the assessment was raised.

The Court of Appeal found that there had been a deliberate inaccuracy but that there was no qualifying discovery.

HMRC appealed to the Supreme Court.

### *Decision*

The Supreme Court held that there had been a valid discovery by HMRC but that the inaccuracy was not deliberate.

The Supreme Court concluded that for there to be a deliberate inaccuracy within s118(7) TMA, there must be 'an intention to mislead' HMRC. Mr Tooth had "done his best" given the inadequacy of the software that he was presented with and, when reading the return in its entirety, he had made it clear as to what he was claiming and why.

Although not necessary, the Supreme Court went on to consider the arguments relating to whether a valid discovery had been made. Both the Upper Tribunal and the Court of Appeal had found that the original discovery was made in 2009 and so by 2014 that discovery had become stale. Interestingly, the Supreme Court disagreed finding that different HMRC officers are able to make the same discovery but at different times, with each entitled to issue a discovery assessment. Further, there is no concept of staleness. Two points from the Press release relating to the Supreme Court's decision are reproduced below:

"First, there is no principle of 'collective knowledge': section 29(1) focuses on the state of mind of the individual officer of the Revenue who makes the assessment; if an officer had already made a discovery, that must not be regarded as a discovery 'once and for all' by the Revenue such that other officers cannot make the same discovery in future [64-65]. This is because of the language and structure of section 29(1) [68], the similar language in section 29(5) [68], the history of section 29 [69], and the ordinary principle of the exercise of powers in public law [70].

Second, there is no concept of ‘staleness’: any idea that a discovery might lose its quality over time is contrary to the ordinary use of language, the leading authorities, and the statutory scheme [73-77]. The question is whether the officer of the Board who is deciding whether to make a discovery assessment has subjectively made a discovery that there has been an under-assessment of tax. It is perfectly possible for someone to make a discovery even if it is something already known to others [78-82].”

*HMRC v Tooth [2021] UKSC 17*