

## **Personal tax round up**

**(Lecture P1216 – 21.04 minutes)**

### **Reinstated bonus**

*Summary – A bonus that was effectively reinstated as part of a compromise agreement was taxable as earnings in 2011/12, the year in which the bonus was earned.*

Thierry Lucas worked for a large international bank but on 18 July 2012 his employment was terminated by mutual agreement.

It seems that there was some disciplinary action taken against him that, under his employment contract, would have meant he lost his entitlement to a bonus payable in respect of the year to October 2011. However, he regained that entitlement by virtue of a Compromise Agreement that was signed in 2012. The bonus was subsequently paid as several amounts during 2012/13.

The main issue to decide in this case was whether the payments received by Thierry Lucas were termination payments or general earnings. If the payments were general earnings, did they fall to be assessed in 2011/12 or 2012/13?

HMRC argued that the bonus payments were earnings taxable under s 62 ITEPA 2003 and that they were earned in October 2011 and so taxable in 2011/12. Terminating his contract by mutual consent, the Compromise Agreement simply preserved his bonus entitlement for the previous tax year. There was no new or additional payment as a result of his termination.

Thierry Lucas argued that the bonus payments received under the compromise agreement were termination payments within s401 ITEPA 2003 and so qualified for full exemption under s413 ITEPA 2003 due to his work abroad. His entitlement to the payments arose from signing the Compromise Agreement with his former employer and so the amounts fell into 2012/13.

#### *Decision*

The First Tier Tribunal acknowledged that until the compromise agreement was reached Thierry Lucas' bonus was lost. However, the reality of the matter was that he was paid nothing by way of compensation for loss of office. The Compromise Agreement simply preserved his employment bonus from when he was employed by the company.

The Tribunal noted that the bonus was paid over a number of years and assessed to tax in those years. However, they found that the bonus was earned in October 2011 and so the payments were for the tax year ended 5 April 2012.

*Thierry Lucas v HMRC (TC07809)*

## **Tax code correctly applied**

*Summary – The Company had acted with reasonable care and correctly applied a new employee's tax code, even though the full amount of tax was not withheld.*

Sci-Temps Limited is an employment agency that began operating PAYE in 2003 and has an exemplary record. Since 2014/15 the Company has complied with its PAYE obligations under RTI.

In 2015/16, a new employee joined Sci-Temps Limited. This was the employee's only employment for the rest of 2015/16 and throughout 2016/17.

On 8 April 2016, HMRC issued the Company with a coding notice for the employee for 2016/17. The notice stated that a tax code of 303T should be used. Sci-Temps Limited correctly operated this code from April 2016.

In September 2016, HMRC changed the employee's code again, which the Company correctly implemented. At the end of the notification letter was the heading 'Previous Pay and Tax Details' followed by 'Previous Pay' of £3,144 and 'Previous Tax' of £0. These figures related to an earlier employment, before the employee joined the Company.

The Company assumed the 'previous pay' figure referred to the employee's earnings from her employment with the Company during the current tax year. Sci-Temps Limited did not include these figures in its deductions working sheet as the employee had begun work for the Company in the previous tax year, and so the Company was not expecting HMRC to provide it with earnings figures for an earlier employment, and to require that those figures be added to its deductions working sheet for the current year.

HMRC later established that the employee had underpaid tax of £629 in 2016/17 and sought to collect this sum from the Company, by way of a determination made under Reg 80 of the Pay As You Earn Regs 2003 for a failure to comply with Reg 68.

Sci-Temps Limited appealed.

### *Decision*

The First Tier Tribunal concluded that the determination issued to the Company was invalid. Reg 68 is headed 'Periodic payments to and recoveries from HMRC: non-Real Time Information employers'. The First Tier Tribunal confirmed that Reg 68 only applies to employers who are not required to operate Real Time Information (RTI) but the Company was an RTI employer.

In case the Tribunal were wrong, they went on to consider if the Company had failed to comply with the PAYE Regulations but concluded that the Company had not. The Company had operated the tax code issued by HMRC. 'Code' is a defined term, being 'a combination of letters, numbers or both' or 'one of the special codes, whether expressed in words or represented by a combination of letters, numbers or both'. The information about previous pay is not part of the code. The Tribunal stated that the employer did not have a legal obligation to include in its deductions working sheet the employee's pay and tax for a previous tax year.

Finally, the Tribunal stated that, even if the determination had been valid, and the Company had failed to comply with a legal obligation, the Company had acted in good faith and taken reasonable care. The Company would not have been liable to pay the excess.

The appeal was allowed.

*Sci-Temps Limited v HMRC (TC07796)*

### **Employees not reported**

*Summary – Immigrant workers paid in cash should have been reported on the company's PAYE returns. HMRC's calculations on the basis of the hours required to operate the restaurant and a payment of minimum wage was acceptable.*

Indian Deluxe Limited ran Indian restaurant. In January 2016, HMRC made an unannounced visit to the restaurant. Following the visit, HMRC claimed that the three staff reported on payroll plus Mr Chowdhury, each working 24 hours per week, were insufficient to cover the opening hours of the restaurant and that not all staff had been reported for PAYE purposes. The owner and manager admitted that not all payments to staff had been reported under PAYE because they had not worked for long and payments were often made in cash at or below the National Minimum Wage. These workers ceased working once they were asked to produce the relevant work-related documents, as they were Bangladeshi immigrants seeking work without work permits.

HMRC sought further information from the company but received no reply. As a result, HMRC issued PAYE determinations and a penalty notice covering the tax years 2012/13 to 2015/16. HMRC believed that that the company was aware of their responsibilities with regard to PAYE and considered that the understatement was deliberate rather than careless, and the assessment was made accordingly.

Indian Deluxe Limited appealed arguing that the PAYE assessment was based on incorrect information as some of the information related to people who did not exist and to people who had given false documents when recruited and had left the job after one week. Further, the size of the business did not support the staff alleged by HMRC and that one person was self-employed, and it was not illegal to take on a self-employed person. Finally, the company submitted that it was not reasonable to treat a small Indian restaurant in the same way as a multinational.

### *Decision*

The First Tier Tribunal stated that it is clear from the legislation that any payment of general earnings is subject to income tax, and that the employer is required to deduct tax from such payments in accordance with the PAYE regulations. There was no doubt that there had been an understatement of PAYE in relation to those employees who ceased working at the restaurant within a short period of time without work permits.

HMRCs calculations were undertaken on the basis of the hours required to operate the restaurant and a payment of minimum wage, rather than on the basis of any specific named individuals. The company did not provide any evidence to show that HMRCs assessment of the hours required was excessive.

The Tribunal found that the company's director was aware of the need to comply with PAYE and there was no reason to believe that PAYE did not apply to their cash payments. The Tribunal confirmed that the behaviour should be regarded as deliberate but unconcealed. There was no unprompted disclosure and so the penalty should be assessed on the basis that the information provision was prompted. The Tribunal agreed with HMRC's penalty calculations particularly as no further substantive information was provided to HMRC following the visit.

Without any supporting evidence, the Tribunal considered that the company had not satisfied them that the PAYE determinations were incorrect and the appeal was dismissed.

*Indian Deluxe Limited v HMRC (TC07729)*

## **Non-charitable expenditure**

*Summary - Money donated by a company to a charity and then loaned back to that company was non-charitable expenditure and was tax avoidance. The company's two tax deductions were disallowed.*

Reb Moishe Foundation is and was a registered charity whose main objective was the relief of poverty and advancement of education amongst persons of the Jewish faith.

Gladstar Ltd made several donations to Reb Moishe Foundation over two years and then in 2006, Gladstar Ltd offered further funds. The charity had no immediate use for these funds. Despite this, Gladstar Ltd suggested that it made the donation anyway and then Reb Moishe Foundation could loan the funds back at a rate of 24%. The company was confident that it could loan the money on at a higher rate. This rate was later reduced to 10%. Gladstar Ltd and the charity were closely linked. One of charity's trustees was a director of Gladstar Ltd and another company director occasionally stood in for this trustee at meetings.

HMRC issued closure notices and amendments for the tax years 2006/07, 2007/08 and 2009/10 totalling some £240,000.

### *Decision*

The First Tier Tribunal concluded that it had been agreed that Gladstar Ltd and Reb Moishe Foundation would enter into the loan agreement so that money flowed in a circle, from Gladstar Ltd to Reb Moishe Foundation and then back to Gladstar Ltd. The effect of the transactions was that the money returned to the company within days of the donation having been made. Prior to making the loans, no independent advice had been taken, nor credit checks undertaken on the company. This was understandable given the close links between the entities.

With the company connected to the charity by one of the trustees, the Tribunal found that on the balance of probabilities, the motivation for the transactions was for Gladstar Ltd to avoid tax. This circular arrangement had produced two tax deductions for Gladstar Ltd:

1. A donation to the charity;
2. Interest paid on the loan made by the charity.

The Tribunal concluded that this was 'precisely the sort of arrangement at which the subsequent "substantial donor" legislation was aimed'.

This was non-charitable expenditure and the tax deductions were disallowed.

*Reb Moishe Foundation v HMRC (TC7785)*

## **Charitable donation carried back**

*Summary – The High Court would not allow the taxpayer to rectify an error on his return, where he carelessly entered an £800,000 Gift Aid donation as half of that amount.*

Following his wife's death in August 2016, Allan Webster established the Christal Foundation through a charity.

In 2016/2017 he sold shares in two companies and realised gains totalling £5.3 million. The following year, on the anniversary of his wife's death, he made a donation of £800,000 to the Charity, intending to claim Gift Aid. The Gift Aid Declaration had been annotated to specify that the donation should be treated as carried back to 2016/2017, a time when he had significant income and gains. His position in 2017/2018 was substantially different and insufficient to support such a Gift Aid donation.

He had originally entered a donation of £400,000 into the software that he used to do his tax return and forgot to amend this to the increased amount of £800,000 that he had subsequently decided to pay. He claimed that as his income tax liability would not have been any different, he failed to spot the mistake. Allan Webster subsequently amended his tax return to show the £800,000 donation actually made.

S426 ITA 2007 allows a taxpayer to carry back a donation to the previous tax year and refers throughout to "a gift" and not to part of a gift. The section requires an election to be made:

"(a) on or before the date on which the individual delivers a return for [the previous tax year]"

As a result, the legislation does not allow carry back figures to be amended after the return is submitted, and also does not permit partial carry back claims, HMRC's denied entirely the carry back Gift Aid claim as the amount of the donation and the original amount entered on the tax return were not the same figure. The £800,000 donation was treated as falling into 2017/18. With insufficient tax in that year to cover the Gift Aid claim, he became liable to pay around £215,000 in tax, interest, and penalties.

Allan Webster applied to the High Court to rectify his original tax return.

## *Decision*

The High Court noted that HMRC had opened an enquiry into Allan Webster's tax return thus starting the statutory process by which it could inquire into his tax returns and amend them. Having issued closure notices in June 2020, Allan Webster had indicated his intention to challenge the closure notices and this appeal to the closure notices had yet to run its course. The High Court concluded that it should not circumvent the tax tribunals, so did not have jurisdiction to amend a return.

They commented:

“The fact that the resolution may not be one that the Claimant wants does not entitle him to circumvent the existing statutory regime and seek to ask the court to exercise its discretionary equitable jurisdiction. It does not mean that the statutory regime is unjust or unfair.”

The judge went on to say:

“... it would be an odd and a surprising result and contrary to public policy if the statutory regime, which cannot be displaced in other circumstances... could be displaced and circumvented by the use of the equitable remedy of rectification.

The High Court concluded that, even if a tax return were in principle a unilateral instrument to which the equitable jurisdiction of rectification could be applied, the Court would not exercise its discretion in favour of the Claimant.

<http://www.bailii.org/ew/cases/EWHC/Ch/2020/2275.html>

### **Pension transfer and omission to draw benefit**

*Summary – The transfer of pension funds into a personal pension plan was not a chargeable transfer for IHT, but the omission to draw benefits from that fund before death did give rise to an IHT charge.*

While married, Mrs Staveley had set up a company, Morayford Ltd, with her husband. By the time of her divorce in 2000, her involvement with the company ceased but she had a large company pension fund. As part of her divorce settlement, her share of the company pension fund was put into a “section 32 buyout policy”.

In 2005, shortly after being diagnosed with cancer in 2004, Mrs Staveley made a will. Her pension fund was still invested in the section 32 policy under which a lump sum would have been payable on her death to her estate and IHT would have arisen. She was aware that the pension was over-funded and that any surplus in the fund on her death would be returned to Morayford Ltd.

A few months before her death in December 2006, Mrs Staveley transferred her pension fund into a personal pension plan, her aim being to ensure that her ex-husband would not benefit from any surplus that was returned to the company.

Under this new pension plan, a death benefit was payable to, or for the benefit of, one or more beneficiaries, at the discretion of the pension scheme administrator. By completing an “Expression of Wish form” that formed part of the “Transfer-in Application Form”, Mrs Staveley nominated her two sons to be considered as equal recipients of the death benefit.

During her life, Mrs Staveley had not drawn any pension benefits from her pension fund and, following her death in mid-2007, the pension benefits were paid out in accordance with her wishes.

HMRC determined that IHT was due on the lifetime transfer of funds into the personal pension plan, as well as on Mrs Staveley’s omission to draw any benefits from her plan before death.

This case has progressed from the First Tier Tribunal to the Supreme Court with various twists and turns at each hearing. The First Tier Tribunal found tax payable on the omission but not the transfer, the Upper Tribunal found no tax payable at all, and the Court of Appeal held that both the transfer and the omission gave rise to a charge to tax.

The Supreme Court agreed that there were two issues to be decided:

1. Was the transfer to the personal pension plan not a transfer of value for IHT as it was a 'disposition not intended to confer gratuitous benefit'?
2. Did Mrs Staveley deliberately omit to exercise a right to draw her pension so that the value of her estate was diminished and the value of another person's estate was increased by that omission?

### *Decision*

The Supreme Court stated that s10 IHTA 1984 applies where the donor does not intend to confer a gratuitous benefit. The Court found that when Mrs Staveley transferred her pension to the personal pension plan she did not intend to confer a gratuitous benefit to her sons. She had made the transfer so as to sever ties with Morayford Ltd and so ensure that none of the pension could be returned to her ex-husband following their acrimonious divorce. She did not make the transfer to increase her sons' inheritance.

Further, the Supreme Court found that when looked at together, the omission and the transfer did not form part of a scheme intended to confer a gratuitous benefit. S10 IHTA 1984 applied to the transfer and no IHT charge arose.

Regarding the second issue, the Supreme Court found that the purpose of her decision not to draw funds was to benefit her sons, as shown by the statement of wishes. It was virtually certain that the scheme administrator would honour her wishes and pay the money directly to her sons. The administrators' discretion did not break the link connecting the omission by Mrs Staveley to draw benefits during her lifetime and the payment of the death benefit to her sons. The omission to draw any pension benefits was the cause of the increase in her sons' estates. The Supreme Court concluded that IHT was payable under s3(3) IHTA 1984.

*HMRC v Parry and other [2020] UKSC 35*

## **Disposals of residential property**

### *Extended functionality*

Remember, for UK residential property disposals made from 6 April 2020, taxpayers have 30 days after the property's completion date to report and pay any Capital Gains Tax due.

When the online reporting system was introduced back in April, taxpayers could only report their first disposal of residential property in a tax year. Where a taxpayer had subsequent disposals in the year, a paper form was required.

Since then, the system has been developed further so that now:

- it can be used to report more than one disposal in a tax year;
- personal representatives and those with power of attorney are able to file the return online.

Unfortunately, the system is still unable to deal with any amendment that is needed to an online return. In such case, the taxpayer must contact HMRC directly.

*<https://www.icaew.com/insights/tax-news/2020/aug-2020/hmrc-extends-cgt-30-day-reporting-functionality>*

#### *ATT Guidance on UK Property Reporting Service*

There have been a number of concerns about setting up the UK property account needed to be able to report these gains. The ATT has published some useful guidance on its website to help deal with agents' concerns.

#### *Digitally excluded taxpayers*

Some taxpayers are 'digitally excluded' due to age, disability, remoteness of location or for any other reason, including religious beliefs. These individuals will need to call HMRC on 0300 200 3300 to either grant their agent access to their online property account or request a paper return. Alternatively, their agent can request a paper return on their behalf via the agent line. Unfortunately, it is not possible to download a form online.

#### *Digitally challenged taxpayers*

These taxpayers are not eligible to contact HMRC to obtain a paper return and must submit their return and payment online through the new system. There are concerns that due to COVID-19 such individuals are not always able to gain the help that they would have normally relied on from family members. HMRC believes that they should be able to access the support that they need from HMRC to be able to authorise their agent to act on their behalf. This is good news for digitally challenged taxpayers with agents but what about individuals with no agent and no access to friends and family at this time?

*<https://www.att.org.uk/uk-property-reporting-service>*