

# Tolley® CPD

October 2022

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## Personal tax

### Unpaid overtime and allowances (Lecture P1336 – 17.57 minutes)

*Summary – The settlement sum was a reward for services, taxable in full as employment income. No deduction was available for the success fee and indemnity insurance that was payable.*

Keith Murphy was one of a number of Metropolitan Police officers who sued the Metropolitan Police for unpaid overtime as well as other employment allowances.

In defending their case, the officers agreed to pay their legal team a success fee should they win but also took out indemnity insurance to cover these costs, should they lose.

Successful in their case, the claimants received £4.2 million plus 'agreed costs' but the success fee and insurance premium were not part of those 'agreed costs'. These were payable directly by the Metropolitan Police from the £4.2 million. The balance was payable to the officers.

The Metropolitan Police taxed the total gross compensation payment received under PAYE but, believing that the success fees and indemnity insurance were deductible costs from the payment, Keith Murphy claimed tax relief for these amounts in his tax return.

Following an enquiry, HMRC raised a discovery assessment on Keith Murphy on the basis that his share of the success fee or insurance premium was not deductible. HMRC argued that the full settlement sum was employment income subject to income tax.

The First Tier Tribunal agreed with HMRC, finding that the full payment arose from employment. How that sum was used, did not change the nature of the settlement amount.

The Upper Tribunal agreed with Keith Murphy and overturned the decision. The amounts used to pay the legal and insurance costs were effectively the same as the agreed court costs.

HMRC appealed to the Court of Appeal.

#### *Decision*

The Court of Appeal found in favour of HMRC.

The fact that the Metropolitan Police paid both the success fees and indemnity insurance directly to the payees did not change the nature of the full settlement sum. This was a reward for services, taxable in full under PAYE.

Indeed, the settlement amount had been increased by £200,000 to recognise the fact that the principal settlement sum would be taxable.

In summary:

- The compensation payment was taxable as employment income;
- The payment of court costs under a court order were non-taxable as these represented the work done by the legal representatives;
- The cost of the success fee and indemnity fee were not incurred necessarily in the performance of the duties of the employment and so were non-deductible.

The First Tier Tribunal's decision was reinstated.

*HMRC v Mr Keith Murphy [2022] EWCA Civ 1112*

### **Inducement to change pension scheme (Lecture P1336 – 17.57 minutes)**

*Summary –The payments made represented compensation for a loss of pension rights and not taxable employment income.*

E.ON UK Plc operated a number of pension schemes for its employees, including two defined benefit schemes which were the subject of this case.

In an attempt to reduce costs, the company made 'facilitation payments' designed to compensate members for a number of changes that were to be made to their employment package. The changes included a two-year pay deal, a requirement for defined benefit members to make increased future pension contributions in order to retain the same level of pensions benefits as before and a commitment by E.ON UK Plc not to make any further pension changes for five years.

Believing that the payments were not earnings, but rather represented compensation for adverse changes made to members' pension arrangements, the company did not deduct PAYE or NICs from the payment made.

HMRC disagreed and raised assessments accordingly.

E.ON UK Plc appealed to the First Tier Tribunal with the case of one individual, Mr Brotherhood, treated as a test case for the members as a whole.

The First Tier Tribunal found that the pension facilitation payment could not be separated from the rest of the negotiated package that was designed to change future employment conditions and that the payment as a whole represented an inducement to provide future employment services. Consequently, the payment was from the members' employment and liable to PAYE and National Insurance.

The company appealed to the Upper Tribunal.

#### *Decision*

The Upper Tribunal found that the First Tier Tribunal had erred in law in finding that the payments were from employment, rather representing compensation.

The Tribunal accepted that the settlement payment represented part of a package that changed future employment conditions. However, the payment represented compensation for the changes made to future pension rights. The payments put the individuals in the same position as before the change.

Remaking the decision, the Upper Tribunal found that the payments were not derived from employment and as a result, not taxable as employment income

*E.ON UK Plc v HMRC* [2022] UKUT 00196 (TCC)

## **Pension tax relief for net pay arrangements (Lecture P1337 – 9.21 minutes)**

For most people, there are two main methods of giving tax relief for pension contributions:

1. net pay arrangements where pension contributions are taken out of an employee's gross pay before tax, thereby automatically reducing the individual's taxable pay; and
2. relief at source schemes which apply to the self-employed and to some employees who pay pension contributions out of their taxed pay (in these cases, the individual obtains tax relief when the pension fund reclaims basic rate tax from HMRC to add to the pension contributions).

While these two procedures provide identical outcomes for many taxpayers, low earners with taxable incomes below the personal allowance can have different levels of take-home pay, depending on how their pension scheme is administered. Those in schemes using relief at source receive a 20% top-up on their pension saving, even if they pay no income tax. However, those in schemes using net pay arrangements receive relief at their marginal rate which, if they are not liable to pay income tax, is effectively 0%. The effect is that low earners in schemes using net pay have less after-tax income than they would if they were saving into a relief at source scheme. This is unfortunate.

The legislation for net pay arrangements is set out in S193 FA 2004. However, the Government are proposing an amendment to these rules by virtue of a new S193A FA 2004. Where an individual is entitled to be given tax relief in accordance with S193 FA 2004 and that person is not liable to pay income tax for the tax year in which the pension contribution is made, there will be a duty on HMRC – with effect from 6 April 2024 – to make arrangements, so far as reasonably practicable, to pay such individuals an 'appropriate amount' in relation to their pension contribution. This will be an amount equal to the income tax relief not already received on the pension contribution. HMRC must pay this top-up as soon as possible after the end of the relevant tax year into the individual's bank or building society account. In order to be able to do this, HMRC will invite eligible employees to provide the necessary details to enable these top-up payments to be made.

Two years ago, the Government launched a Call for Evidence in this regard which ran between July and October 2020. The Call for Evidence set out three reform principles which had to underpin any changes:

1. simplicity;
2. deliverability; and

### 3. proportionality.

The response which followed committed the Government to introducing a top-up payment for low earners using net pay arrangements, seeking broadly to equalise their take-home pay with comparable low earners using relief at source schemes.

*Contributed by Robert Jamieson*

## **Buying and selling horses (Lecture P1336 – 17.57 minutes)**

*Summary - Enterprise Investment Scheme relief was denied as the risk to capital condition was not met and the company did not meet the qualifying trading requirement.*

Valyrian Bloodstock Limited, incorporated in February 2019, sought to raise horses as well as buy and sell bloodstock.

In 2019, the company bought six horses for £192,400 with the intention to sell these horses when they were two or three years old, without training them. Once sold, the proceeds would be reinvested in new bloodstock, with all remaining funds used for the upkeep of the horses. No further horses could be bought until one was sold.

In March and June 2019, shares were allotted to four investors. In November 2019, the company provided HMRC with four EIS1 compliance statements

With no advance assurance from HMRC confirming that EIS relief would apply, HMRC requested additional information. This confirmed that the horses were stabled with a third party, financial information was, 'sketchy' and 'inaccurate'. There were no financial forecasts nor a business plan and other documentation provided was shown to be in draft form only. HMRC believed that Advance Assurance had not been sought because the required supporting information was not available.

HMRC refused to issue the required EIS certificates stating that the Risk to capital condition had not been met. There was no evidence to demonstrate that the company intended to grow and develop its activities in the long term.

More specifically, HMRC stated that:

- There was no indication that the number of employees or turnover were likely to be increased;
- The company had neither provided any financial forecasts nor a business plan to demonstrate growth and development of the company in the long term.
- None of the money raised from selling a horse was used to build the company's infrastructure;
- With almost everything done by third parties, the company was not acquiring expertise that it would use to build its brand and reputation in the long term;
- The company was not being managed by entrepreneurs. The investors were individuals using a tax advantaged scheme with little or no entrepreneurial involvement.

Further, HMRC argued that the company did not meet the qualifying trading requirement as its activities consisted of dealing in goods of a kind held as an investment.

Valyrian Bloodstock Limited appealed to the First tier Tribunal.

### *Decision*

The First Tier Tribunal stated that it was necessary to look at the circumstances at the time the shares were issued, together with other supporting evidence available at that time.

The Tribunal stated that they saw no evidence of how revenue would increase through time. In fact, the evidence provided showed that the company intended to use all of its funds raised on the purchase of the horses and their upkeep. The company failed to provide financial forecasts nor a business plan to demonstrate growth and development of the company. The Tribunal concluded that there was nothing to suggest that this would be anything other than a three year investment.

The Tribunal concluded by stating:

“Looked at objectively, we find that it was an investment opportunity in a “wrapper” that was perceived as being tax efficient.”

The horses were held for capital appreciation rather than as trading stock.

The appeal was dismissed.

*Valyrian Bloodstock Limited v HMRC (TC08578)*

## Capital taxes

### Payments under a consent order (Lecture P1336 – 17.57 minutes)

*Summary - Payments that were made under a High Court consent order were not deductible enhancement expenditure under s.38(1)(b) TCG 1992.*

St Peter's Farm in Oxfordshire was owned by Dora Slade and comprised a farmhouse, garden, grounds and farmland. On her death:

- Jonathan James Slade, her son, inherited the farmland;
- Her residuary estate comprising the farmhouse, garden and grounds were left on trust for various family members including Jonathan James Slade.

In 1987, the farmhouse, garden and grounds were split into three separately registered titles known as the Farmhouse, the Northern Parcel and the Southern Parcel. The Farmhouse was sold without dispute.

By June 2009, Jonathan James Slade was the sole executor and trustee under Dora's will, the other executors and trustees having died.

Sometime after 2010, Jonathan James Slade was advised that the two parcels of land had in fact remained part of the farmland which meant that Jonathan James Slade was beneficially entitled to that land; it did not fall within the residuary trust.

In 2012, Jonathan James Slade assented to both Parcels of land being transferred to Jonathan Mark Slade, his son, and himself as tenants in common. The titles to the land were registered accordingly.

In August 2015, the two men sold the Southern Parcel, with planning permission, for £250,000. It was this disposal that gave rise to the CGT issue in this appeal.

On 12 March 2018, the other family members commenced a claim in the High Court in their capacity as beneficiaries of the residuary trust under Dora Slade's will. They sought the following remedies for alleged breaches of trust and/or fiduciary duty:

- 1) A declaration that Jonathan James Slade and Jonathan Mark Slade held both parcels of land on the residuary trusts of Dora's will.
- 2) An order that Jonathan James Slade and Jonathan Mark Slade account to the beneficiaries for the proceeds of sale of the Southern Parcel and any profits obtained from those parcels of land.
- 3) In the alternative, damages for breach of trust and/or breach of fiduciary duty in a sum equal to the value of the parcels of land.

The father and son disagreed, claiming that Dora Slade's will did not intend the parcels of land to pass together with the Farmhouse as part of her residuary estate.

The High Court claim was settled shortly before the hearing by way of a consent order dated 8 August 2019, resulting in costs and payments to be made to other members of the family totalling some £275,000.

Jonathan James Slade and Jonathan Mark Slade claimed a deduction for the payments and costs in arriving at their chargeable gain

HMRC denied the deductions claiming that they did not fall under s.38(1)(b) TCGA 1992 which states that an amount is deductible if the expenditure is wholly and exclusively incurred on to establish, preserve or defend title to, or to a right over, the asset.

HMRC stated that the sums were incurred in preserving or defending entitlement to the proceeds of sale of the land, and not the land itself. Alternatively, the expenditure was partly incurred in preserving or defending entitlement to the proceeds of sale and partly in defending title to land.

Jonathan Mark Slade and Jonathan James Slade appealed.

### *Decision*

The First Tier Tribunal found that the payments were incurred in respect of both the Southern and Northern Parcels of land and not wholly and exclusively on the Southern Parcel. Consequently, the payments and legal costs could not be said to fall within s.38(1)(b) TCGA 1992.

The First Tier Tribunal went on to say that the High Court Claim was a claim over the proceeds of sale of the Southern Parcel and not title of the land which had been sold. The Tribunal saw the payments made under the consent order as damages, rather than the costs of defending title to the land. The Tribunal stated:

“The right to take court action for compensation or damages is an asset for CGT purposes. Consequently, where a person receives compensation there is a disposal of an asset for CGT purposes and strictly there may be no acquisition cost. ESC D33 provides a concessionary treatment where the right of action arises in relation to damage to an underlying asset. The gain may be treated as if the receipt of compensation or damages was a part disposal of the underlying asset. Where there is no underlying asset, any gain on disposal of the cause of action may be exempt up to a limit of £500,000.

It is not clear to us that the other family members would be liable to CGT on receipt of the damages provided for in the Consent Order. In particular, they were seeking to enforce their rights as beneficiaries under Dora’s residuary will trust. They were not seeking to obtain title to the land themselves. As such, it is not clear that there was any underlying asset. It may be that their disposal of the right of action would not be taxed as a matter of concession. In any event, .... the tax treatment of damages in the hands of the other family members is irrelevant to the tax treatment of the appellants’ disposal of the Southern Parcel.”

The appeal was dismissed.

*Jonathan Mark Slade and Jonathan James Slade v HMRC (TC08548)*

## Services provided by 'apart-hotels' (Lecture P1336 – 17.57 minutes)

*Summary - Serviced apartments were an investment business meaning that no business property relief was available.*

The L Batley 1984 Settlement held just under one third of the shares in The Lawrance (Hotel) Living Ltd, which in turn owned four properties in York and Harrogate. Each of the properties consisted of a number of serviced apartments, a cross between hotels and self-contained apartments. The majority of guests were corporate customers who stayed for between one and three nights, who were given tea, coffee, milk etc, as well as WIFI, bedding and towels.

A ten-year anniversary charge was due on 14 November 2014, with the trustees claiming 100% business property relief on the trust's shareholding in the company.

HMRC denied the relief on the grounds that the business was holding investments, and not trading, meaning that it was not eligible for the relief.

The trustees appealed.

### *Decision*

The First Tier Tribunal found that although a business, guests rarely spoke to staff and food and extras accounted for less than 5% of turnover. The business was not a hotel business but rather serviced apartments.

The reception was not used by guests but rather as an administration centre from which the apartments were serviced.

The Tribunal acknowledged that some apart-hotels could be categorised as providing services together with accommodation, this was not the case here. The company's principal activity was investment, so no business property relief was available.

The appeal was dismissed.

*Bruce Firth and Rita Firth as The Trustees of The L Batley 1984 Settlement v HMRC (TC08542)*

## Additional dwelling supplement and COVID (Lecture P1336 – 17.57 minutes)

*Summary – Although he sold his second property, the taxpayer remained liable to the Additional Dwelling Supplement charge as his circumstances did not fall within the conditions required to allow a repayment to be made.*

In February 2020 Iain Robertson bought a house and filed the electronic Land and Buildings Transaction Tax return online the same day. Already owning a flat that he had been unable to sell due to the COVID lockdown, he paid the £4,000 Additional Dwelling Supplement that fell due.

Once lockdown eased, the family who had intended to help him renovate the new house so that he could live in it were no longer able to do so. His savings had been used so he did some of the work himself, but due to underlying health conditions, he then spent three weeks in bed unable to do very much at all. His mobility deteriorated significantly.

Reluctantly, in April 2021, he sold his new house and his lawyer submitted a claim for repayment of the Additional Dwelling Supplement of £4,000.

HMRC denied the repayment stating that the conditions for Additional Dwelling Supplement repayment were not met.

Iain Robertson appealed, arguing that he had “been caught by a set of rules that were not meant” for his situation.

### *Decision*

The Tribunal acknowledged that this was a very sad case. Iain Robertson had intended to occupy the house, but due to factors outside of his control, he had not done so.

It was the Scottish Parliament’s intention that Additional Dwelling Supplement should only be repayable in the limited circumstances set out in paragraph 8(1) Schedule 2A LBTAA.

Under paragraph 8(1)(a)), to be eligible for a repayment the buyer must dispose of the ownership of a dwelling (other than one that was or formed part of the subject-matter of the chargeable transaction). Since it was the house which triggered the payment of Additional Dwelling Supplement, it was the house which formed the subject-matter of the chargeable transaction. The disposal of the house could not trigger the repayment of the supplement.

Revenue Scotland could only apply the legislation as drafted; they had no discretion to change the rules based on Iain Robertson’s individual circumstances.

The appeal was dismissed.

*Mr Iain Robertson v Revenue Scotland [2022] FTSTC 6*

## Administration

### 'Fishing expedition' not allowed

*Summary - Information notices were varied to restrict them to relevant information that was reasonably required and the taxpayer was directed to comply with these notices within 30 days of the release of the tribunal's decision.*

Matthew Jenner filed income tax returns for 2016/17 and 2017/18 on 26 April 2019. On 9 July 2019, HMRC issued notices of enquiry and information notices in respect of those years arguing that his lifestyle did not match reported income. HMRC sought information in three categories:

1. Household expenditure - details of household and personal expenditure including rent, utilities, food, holidays; including an explanation of how these were met;
2. Financial information - including details of director's loan accounts and sums drawn down from trusts, partnerships and other individuals;
3. Personal accounts - a schedule of all personal financial accounts, in his own name or in joint names or over which he had control or the power to operate, together with bank and building society statements.

Matthew Jenner appealed against the information notices on 7 August 2019 arguing that the information or documents requested was not reasonably required for the purpose of checking his tax position and that the "broad scope of the information requested also demonstrates that HMRC is engaging in a fishing expedition."

Following HMRC's statutory review conclusion letter, on 23 February 2020, Matthew Jenner appealed to the Tribunal.

#### *Decision*

The First Tier Tribunal stated that making broad requests fishing for information without having any reason to suspect that it was wrong would not meet the 'reasonably required' test.

1. Matthew Jenner was not required to give out details of his personal household and holiday expenditure if it could be avoided and HMRC's 'broadly-drafted request' was not reasonably required to check his tax position. HMRC failed to demonstrate that the information sought was reasonably required to address an apparent insufficiency of declared income.
2. Matthew Jenner accepted that there was a gap between taxable income and expenditure. Although he claimed that he was living on loans, it was reasonable for HMRC to check whether there were other sources of income and/or gains that could have been used to cover the difference between incomings and outgoings. It was reasonable to extend the information request to all entities in which Mathew Jenner had an interest, not just those which related to business. This included dividends or gains from investments. The financial information requested was the sort of information needed to check a taxpayer's position and so was reasonably required.

3. The personal accounts information requested was basic financial information, meaning that this too was reasonably required.

*Matthew Jenner v HMRC (TC08528)*

## Retrospective charges for ATED penalties

*Summary – Daily late filing penalties for failing to submit ATED returns on time could be charged retrospectively.*

The two appeals were heard separately by the First Tier Tribunal. In both cases, the companies submitted annual tax on enveloped dwellings returns late and, after the returns were received, HMRC charged an initial fixed penalty of £100.

In the notices charging the penalties, HMRC stated that daily penalties under Sch.55 para 4 FA 2009 would be charged if the returns were more than three months late.

HMRC later issued notices for the maximum daily penalties and also further fixed penalties.

Both companies appealed against the penalties.

The First Tier Tribunal dismissed Priory London Ltd's appeal but allowed Jocoguma Properties Ltd's appeal in respect of the daily penalties, saying a notice under Sch 55 para 4(1)(c), specifying the date from which the daily penalty was payable, could not be given retrospectively. As the return had already been filed when HMRC gave the notice, no daily penalty was due.

The tribunal had followed the conclusion in another First Tier Tribunal decision, *Heacham Holidays Ltd (TC7883)*, that para 4(1)(c) had to be construed purposively. The purpose of the notice was to warn the taxpayer that they would be liable to a daily penalty if their failure continued during the following 90 days, and the notice had to be given in advance of the start of the 90-day period.

### *Decision*

The Upper Tribunal said the First Tier Tribunal in *Jocoguma Properties Ltd* had erred in law. This was because it followed the *Heacham* decision which had itself been wrongly decided. The tribunal in that case had relied on the Upper Tribunal judge in the *Donaldson case* [2015] STC 689 saying the purpose of para 4(1)(c) was to warn the taxpayer about daily penalties, but this had resulted in an error for two main reasons.

First, para 4 had to be read as a whole, and para 4(3) clearly stated that the date specified in the notice could be earlier than the date of the notice itself. The judge said:

'We do not see how that can be read otherwise than to permit the notice to be given retrospectively.'

Second, *Donaldson* was an income tax case and the Upper Tribunal had considered the purpose of para 4 in that context. It had not decided that warning the taxpayer was the sole purpose of a notice, but that it was a purpose. This was not inconsistent with there being another purpose where HMRC could not know that the taxpayer had a filing obligation until a return was actually filed, as with ATED.

The Upper Tribunal therefore dismissed Priory London's appeal and allowed HMRC's appeal against the Jocoguma Properties Ltd's decision.

*Priory London Limited v HMRC and HMRC v Jocoguma Properties Ltd*

*Adapted from the case summary in Taxation (8 September 2022)*

### **A discovery assessment (Lecture P1339 – 15.41 minutes)**

The decision in *Johnson v HMRC* (2022) was published by the First-Tier Tribunal on 4 May 2022. This is an interesting case which concerned a discovery assessment for 2013/14 issued in November 2018 under S29(4) TMA 1970 on the basis that the insufficiency of tax was brought about carelessly or deliberately by the taxpayer or by a person acting on his behalf.

In January 2014, the taxpayer (J) had received a compensation payment from NatWest in respect of an interest rate financial hedging product following a review by the Financial Conduct Authority. HMRC considered that such receipts were taxable and said so in guidance which can be found on their website. J's tax adviser was aware of the HMRC guidance but felt that there was ambiguity in relation to the taxability of this particular receipt. Accordingly, disclosure was merely made in the white space of J's self-assessment tax return for 2013/14.

A full disclosure of the relevant details in the white space of a tax return provides a defence to a discovery assessment by reason of S29(5) TMA 1970 on the ground that the HMRC officer could reasonably be expected to be aware of the insufficiency as a result of the information provided by the taxpayer. Unfortunately, however, this defence does not hold good for discovery assessments made under the 'careless or deliberate conduct' provisions of S29(4) TMA 1970 – it only applies to the 'reasonable expectation' requirements in S29(5) TMA 1970.

In other words, the issue in this case was whether J's adviser had been 'careless'.

The First-Tier Tribunal held that J's adviser had been careless and that the discovery assessment was valid. The adviser knew about the HMRC guidance and should have included the receipt as part of J's taxable business income. He was careless not to have done so. The guidance which the adviser read makes it clear that such redress payments should be treated as business income – J was in receipt of rental income from a property which he had purchased with the aid of a loan several years ago. The compensation payment related to that loan. Property profits constitute a form of business income. Although the adviser had seen HMRC's guidance which suggested that, if the redress product related to a non-business loan, the payment was not taxable as income, it was, in the First-Tier Tribunal's view, unbelievable that an experienced practitioner such as J's adviser would not be aware that letting out property represented a business and that the payment should have been treated as taxable.

However, one experienced commentator has made this point:

'This seems a bit tough. (The adviser) was careless just because he did not follow HMRC's guidance but put the details in the white space. The First-Tier Tribunal accepted that there may have been some ambiguity but said that an experienced . . . adviser would have thought it pretty likely that the receipt would be taxable.'

This (seems to be) a new test – and it is not clear why a new test is required, having regard to the well-established test for carelessness.’

Tax legislation defines carelessness as a failure by the taxpayer to take reasonable care. When the harmonised penalty regime was introduced several years ago, the idea of failure to take reasonable care was likened to the general law concept of negligence.

Although the old case of *Blyth v Birmingham Waterworks Co* (1843–60) gave a definition of negligence which has often been cited in the First-Tier Tribunal and its predecessors, it is nowadays thought that a modern formulation of what constitutes a failure to take reasonable care such as that found in *Collis v HMRC* (2011) is more appropriate.

Thus:

‘We consider that the standard by which this falls to be judged is that of a prudent and reasonable taxpayer in the position of the taxpayer in question.’

It is not clear whether – to summarise the First-Tier Tribunal – an experienced adviser would have thought it ‘pretty likely’ that the redress payment was taxable corresponds to the test enunciated above. Maybe it does.

Finally, however, the following question has to be asked: what protection does a white space disclosure provide? Not much, it seems. If the conclusion from the information in the white space is correct, then one does not need to have made the disclosure at all. And, if it is wrong, the taxpayer or his adviser must have been careless – which puts one in the same position as if one had not made any disclosure. Can this really be correct?

*Contributed by Robert Jamieson*

## **Opening aspect enquiry letters (Lecture P1340 – 14.34 minutes)**

This article will consider a practical example of an opening enquiry letter for an aspect enquiry and provide advice on issues arising.

Reference should be made to a previous session, ‘Dealing with the opening enquiry letter’, where I covered various aspects of the subject, including statutory provisions and guiding principles to apply when responding to HMRC’s letter.

### *Sample letter*

Over the page is an extract of a sample letter, typical of the type of correspondence a, individual taxpayer may receive when HMRC starts an aspect enquiry.

Indv and Small Business Compliance HM Revenue and Customs  
BX9 1LE

**Phone** 03000 xxxxx

**Email** xxx.xxx@hmrc.gov.uk

**Web** www.gov.uk

Date 12 October 2021

Our Ref UTR xxxxx

Dear xxxxxx

### **Check of Self-Assessment tax return for the year ended 5 April 2021**

Thank you for your return for the year shown above, which we received on 7 July 2021.

Every year we check a number of returns to make sure they are correct and that our customers are paying the right amount of tax. I am now checking this return under Section 9A of the Taxes Management Act 1970.

#### **What I am checking**

I will be looking at gains on property disposal. This follows a review of information that HMRC holds, including details received from my colleagues in the Valuation Office Agency.

When I look at this area, I may find that I need to extend my check. If this happens, I will let you know.

#### **What I need from you**

To help me with my check, please let me have the items lists on the enclosed schedule.

Please send what I have asked for by 11 November 2021. If you need help or more time to do this, please phone me on the number shown at the top of this letter.

#### **What will happen if you do not give me what I have asked for**

If you do not give me what I have asked for, or we are unable to agree the amount of any additional tax you owe, I may make an assessment of how much I think you should pay. To do this, I will use the information available to me.

#### **Completing my check**

Once I have worked out whether there is any additional tax for you to pay, I will let you know. I will also let you know about any interest and penalties that may be due.

You may want to consider making a payment on account of any tax that you think you may owe, to stop the amount of interest from increasing.

### *Information request*

Below is an information request with the enquiry letter:

#### **Schedule of information and documents needed to carry out our check**

Customer name: xxxx

Our reference number: xxxx

To help us with our check we need the following information and documents:

#### **Information and documents**

Please provide the following documents and information for the period 6 April 2020 to 5 April 2021 inclusive. If there is no information/documents available or the question is not applicable, then please explicitly state this in your response.

#### **Property**

1. A schedule showing the full address of all UK and overseas properties and land owned either solely or jointly during the period.
2. For each property detailed under point 1, please provide a copy of the completion statement in respect of the property purchase and sale.
3. For each property detailed under point 1, please provide the following details:
  - a. Acquisition date
  - b. Acquisition cost
  - c. Sale date, if applicable
  - d. Sale value, if applicable
  - e. A schedule of all incidental expenditure linked to the purchase and sale of the property. Please send the documentary evidence to support the items listed on this schedule
  - f. A schedule of all enhancement expenditure incurred on the property showing the amount, date and a description of the expenditure. Please send the documentary evidence to support the items listed on this schedule
  - g. An explanation as to how the property purchase was funded, supported with the relevant documentation such as mortgage or loan schedules and statements
  - h. If you received rental income from the property, please provide a statement showing the amount received
  - i. If you occupied the property as a residence at any time during your period of ownership, please confirm the dates you occupied the property and provide documentary evidence to prove you were resident

## Notes

In this context 'documents' means anything in which information of any description is recorded. This includes any records held on computer, magnetic tape, optical disk (CD-ROM/DVD), hard disk, memory stick, flash drive, floppy disk or other recording media.

Many of the principles discussed in the previous session referenced above apply to an aspect enquiry. An adviser is likely to see more aspect enquiries than opening letters for full enquiries. In practice, opening enquiry letters will also include any relevant factsheets, and standard information regarding the disposal of documents sent to HMRC.

### *Aspect enquiry*

It is easy to be lulled into a false sense of enquiry when faced with this type of HMRC compliance check. The reality is that, if other areas of concern emerge for the enquiry officer, the enquiry can be extended to a full enquiry. In addition, where the officer considers that a correct and complete response has not been provided by the taxpayer, the enquiry can be switched to a fraud investigation, whether under Code of Practice 9 or a criminal investigation with a view to prosecution.

### *Information request*

It is important for the adviser to review each request for information and documents in the context of the particular client. The adviser needs to consider whether the items requested are relevant and reasonably required by HMRC to check the taxpayer's position, or whether they are part of a "fishing expedition" by HMRC.

Advisers should remember that an essential part of dealing with an enquiry letter is to discuss the position with the client, before sending any response to HMRC. That is as important when dealing with an aspect enquiry as with a full enquiry. Where the client indicates that there is a disclosure to be made, it will not usually be appropriate to simply provide the information requested by the enquiry officer. In such circumstances, reference should be made to my session on making a voluntary disclosure.

As noted above, aspect enquiries should not be underestimated, as they can, in appropriate circumstances, become a full enquiry, or, a fraud investigation, including one in which HMRC use their criminal investigation powers.

*Contributed by Phil Berwick, Director at Berwick Tax*

## **MTD accounting records (Lecture B1338 – 22.02 minutes)**

### *The legal background*

The MTD for Income tax legislation was introduced into Taxes Management Act 1970 by the Finance (No 2) Act 2017. This introduced Schedule A1 which is not currently in force, but which sets out the structure of Making Tax Digital and provides for regulations to be made to secure the detail.

Schedule A1 requires persons within the scope of the legislation (Broadly sole traders and landlords) to 'keep specified information in digital form'. They are also required to retain those digital records for a specified period of time.

To supplement the primary legislation the Regulations – The Income Tax (Digital Requirements) Regulations were issued in September 2021. (SI 2021 No 1076). These provide additional detail on how the broad requirements of Schedule A1 are to be met.

#### *Functional compatible software*

The requirement for businesses to keep digital records encompasses the use of ‘functional compatible software’. This term was also used in the VAT Regulations, and covers one or more software products but also includes spreadsheets, which when used together provide the following functions:

- The creation of a digital record of transactions;
- The retention of that record for the requisite period required by tax law;
- The submission of quarterly updates and end of period statements to HMRC using API architecture;
- The receipt of information from HMRC relevant to compliance with these processes using API architecture.

The precise content of the digital records in terms of the analysis of transactions will be provided by an ‘update notice’ which is to be issued under the Regulations, the so called tertiary legislation presently being available in draft form as of summer 2022.

#### *Digital records – specific content*

Regulation 6 (SI 2021/1076) provides the skeleton of what information needs to be captured digitally, and it is similar to the VAT rules in providing only a requirement for brief data items as follows :

For each transaction :

- The amount of the transaction
- The date of the transaction (according to the basis used for reporting for income tax purposes – cash accounting or full GAAP accounting under ITTOIA 2005)
- The category into which the transaction falls – this is to be specified in an ‘Update notice’.

#### *Timing of digital record keeping*

Regulation 5 requires that transactions are entered into the digital records at the earlier of:

- The deadline for submission of the quarterly update, or
- The point at which the quarterly submission is about to be submitted

So, in practice, this allows record keeping to be done at a minimum on a quarterly basis, although many advisers will probably decide that real – time record keeping (or as near to it as possible) will be their preferred solution.

### *Analysis of transactions*

The analysis required for the transaction records are given by the draft Update Notice, which specifies the content of the quarterly updates, which in turn prescribes the analysis in the records. The draft notices provide for the following headings:

#### Trade

- Income - as follows:
  - Turnover
  - Other business income
- Business expenses as follows:
  - Cost of goods bought for resale or goods used
  - Construction industry – payments to subcontractors
  - Wages, salaries and other staff costs
  - Car, van and travel expenses
  - Rent, rates, power and insurance costs
  - Repairs and renewals of property and equipment
  - Phone, fax, stationery and other office costs
  - Advertising and business entertainment costs
  - Interest on bank and other loans
  - Bank, credit card and other financial charges
  - Irrecoverable debts written off
  - Accountancy, legal and other professional fees
  - Depreciation and loss/profit on sale of assets
  - Other business expenses

However, the draft notice does permit traders with turnover below the current VAT threshold of £85,000 to provide a simple total of income and expenses with no further analysis.

#### Property income – UK non FHL

- Income
  - Total rents
  - Other income
  - Tax deducted from rent and other income from property
  - Premiums

- Reverse premiums and inducements
- Expenses:
  - Rates, insurance, rent and ground rent
  - Property repairs and maintenance
  - Residential property finance costs
  - Non-residential property finance costs
  - Legal, management and other professional fees
  - Costs of services provided, including wages
  - Other allowable property expenses

Again the draft notice provides for total income and total expenses to be shown, but residential finance costs must be separated.

#### Overseas property income

The categories of expense are the same as for UK property. The income categories are:

- Total rents
- Premiums
- Other receipts

#### UK Furnished Holiday letting (EEA FHL similar)

- Income
  - Rents received
  - Income from services provided to tenants (not required for EEA FHL)
- Expenses:
  - Rent paid, repairs, insurance and cost of services provided
  - Loan interest and other financial costs
  - Legal, management and other professional fees
  - Other allowable property expenses

#### *Retailers*

The draft retail sales notice permits retailers to keep alternative records – showing a daily sales taking records rather than by individual transactions, which matches the requirement for VAT. There is more detail in the draft notice on what is to be included in this amount.

#### *Errors and omissions in digital records*

Where there has been an error or omission in the digital records, Reg 17 requires the person to correct the records as soon as possible. When this has happened, if the End of Period

Statement (EOPS) has not been filed for the period including that error, the person must include the correction on their next submission of either a quarterly update or EOPS, depending on which is next to be filed.

However, it is now clear that the expectation is that errors will be corrected **within the appropriate quarter's records** rather than within the subsequent quarter. This means that where errors have been corrected, the taxpayer will be required to resubmit the relevant quarter with the updated totals. This is a practical issue which has only just emerged, as the understanding was that the quarterly submissions would be made on a cumulative basis, and would thus 'self-correct' as necessary. Requiring the resubmission of corrected quarters adds quite significantly to the burden imposed by MTD, particularly when the taxpayer is using spreadsheets and bridging software to comply with the requirements.

#### *Practicalities – trades*

The headings specified follow exactly the current headings on the SA103 which means that traders with more detailed and sophisticated charts of accounts will need a mapping function to allow the updates to be prepared as required. Other than that, where businesses are using proprietary branded software the requirements should present no problems. There are also a number of products which, while not offering a full ledger based accounting system will allow traders to link their bank account and classify their transactions ready for submission.

The use of spreadsheets by smaller businesses should also not be a particular challenge. Bridging software is currently being developed which will allow a simple spreadsheet with column totals to be used to collate the records, with bridging software used at the end of the quarter to make the submission. It is clear that the spreadsheet and bridging software will be required to use digital links to the data, but this is already an established practice when submitting VAT returns so adds no further complexity for those using this method for filing VAT returns.

Clients with more than one trading activity will be able to use a mix of spreadsheets and accounting products as each trade will be a separate submission on a quarterly basis (and a separate End of Period statement).

#### *Practicalities – property income*

The current design of HMRC's system makes compliance for landlords with a variety of sources of property income very challenging.

There must be only two submissions in respect of property income for each quarter – one for UK property, comprising the datasets for FHL and non FHL letting, and one further in respect of overseas property (probably with data sets for each country in which there is a let property to allow for separate recording of foreign taxation suffered). Note that the draft notices do not seem to record the foreign tax suffered on the income, which presumably is submitted at the end of the tax year.

Where there is a joint let, the current HMRC view is that each of the property owners must keep their own records of their share of each transaction; this record will then need to be combined with records of wholly owned properties and other joint lets with other parties to make a single submission.

This means that landlords with a mixed UK portfolio will either have to keep all of their property income records on a single software product or will need to export from various software and spreadsheets to then combine all of their sources of property income into a single submission. It is not presently clear how this can be achieved.

#### *Practicalities – bookkeepers*

At present HMRC cannot authorise more than one agent to act for a taxpayer for any single 'head of duty' (tax, such as Income tax). This will produce significant problems under MTD when bookkeepers act for a trader and wish to make submissions in year, but then hand over to an accountant to deal with the End of Period Statement and finalisation of the tax position. There is no technical solution to this issue at present, which has been a feature of HMRC's systems for so long that it is deeply embedded in the operating systems.

*Contributed by Rebecca Benneyworth*

### **Personal Liability Notices for Directors (Lecture B1340 – 22.24 minutes)**

The Social Security Administration Act 1992 was amended in 1998 to introduce a concept of personal liability for directors of companies which failed to pay NIC due.

HMRC may issue a "personal liability notice" (PLN) on any director (or other officer) of a company when the company has failed to pay contributions within the time allowed (not necessarily under circumstances of insolvency) where that failure to pay appears to be due to the fraud or neglect of individuals who were at the time of the failure to pay, officers of the company. In such a case the officer is referred to as a "culpable officer" (SSAA1992 s121C).

HMRC will issue the notice, taking into account the extent of the officer's culpability in the company's failure to pay, and may share the liability between more than one individual. If the company subsequently makes payment, then the liabilities shown on the notices are correspondingly reduced. Interest may be added to the contributions due by the company (which will include both primary and secondary contributions, and Classes 1A and 1B if appropriate) and will be included in the PLN.

The notice is issued following the company's failure to pay by the due date, and not necessarily its inability to pay. However it is unlikely that HMRC would use this power if they had the option of pursuing the company for the funds.

Although the legislation provides for an "officer" to be personally liable for unpaid NIC's, it is unlikely that a company secretary rather than a director would have the degree of control over the company's affairs to be held responsible for the failure to pay

#### *What are the indicators of neglect?*

A review of appeal cases against PLN's under s 121C indicates that HMRC generally pursues directors where there has been no attempt to make payment of PAYE and NIC and in particular where the individuals involved have been associated with companies which have previously gone insolvent owing HMRC substantial amounts of money.

It is worth noting that the number of appeal cases recorded recently has dropped to a very low level, probably indicating that the introduction of Real Time Information (RTI) for payroll

allows HMRC to intervene much earlier when NIC is unpaid and thus the serious cases for which PLN's have been issued in the past are not much in evidence.

*Appeal case study : TC01130 Stephen Roberts and Alan Martin v HMRC*

This appeal case concerned the Personal Liability Notices issued against the appellants which totalled £90,959 (each individual being issued with a notice for half of that amount) being the estimated unpaid NIC due by Innova Limited.

The company was incorporated in June 2007 and carried on business as a staff agency, providing staff to banks and other financial organisations, both as a recruitment consultant and the provider of staff (both employees of the company and sub-contractors).

Innova was a successor (phoenix) company to Synergi Global Solutions Limited, a company of which both the appellants were directors, and which operated the same business as Innova. Synergi went into liquidation in July 2007 with PAYE, NIC and VAT debts of about £165,305 of which £103,733.07 was attributable to outstanding PAYE tax and NIC.

Innova kept payroll records showing that PAYE tax and National Insurance contributions (NIC) had been regularly deducted from the wages of its employees. The records showed that between 31 July 2007 and 31 March 2008, PAYE tax and National Insurance of £220,708.36 were due and payable to HMRC. No sums in respect of PAYE or National Insurances were ever remitted by Innova to HMRC although throughout that period, the Appellants paid themselves substantial salaries and expenses. Mr Martin's salary was £75,000 per year and Mr Roberts' was £125,000 per annum.

Innova had an accountant who prepared monthly payroll sheets showing payments due to employees and the total PAYE Tax/National Insurance Contributions. Monthly payroll sheets were produced showing payments due to employees and total PAYE tax and National Insurance Contribution (NIC). The Appellants were aware that Innova had a statutory obligation to pay PAYE tax and NIC to HMRC each month. Innova's accountant was responsible for sending PAYE tax and NIC to HMRC on the instructions of a director. The Appellants were the sole signatories on Innova's bank account.

No such instructions were ever given, as no NIC or PAYE tax was ever remitted by Innova to HMRC. Each month, from the outset of Innova's trading, the Appellants conducted a financial review and each month they took the decision to refrain from making any payments of PAYE tax or NIC.

At no stage, while Innova was trading, did the Appellants contact HMRC to discuss Innova's failure to pay PAYE tax or NIC. Instead, they resolved to pay creditors on a business critical basis. This basis involved continuing to pay their own salaries and creditors with whom they might do business with any successor company to Innova.

Shortly before Innova went into liquidation, certain contractors were paid to ensure that their services could be used by a planned successor company (Cornerstone Resources Ltd). In particular, between March and April 2008, trade creditors were reduced from £104,025.21 as at 17 March 2008 to £24,119.51 as at 2 April 2008. However, no payments were made to HMRC. Innova ceased trading on or about 18 April 2008.

Cornerstone began trading in about May 2008 when a PAYE scheme was set up. It had the same registered office as Innova. The Appellants were the directors of Cornerstone and they awarded themselves the same salaries they had received from Innova. HMRC officers visited

Cornerstone's accountant on 27 February 2009 to examine Cornerstone's payroll records in order to quantify the debt owed to HMRC. No payments of PAYE tax or NIC were made by Cornerstone until 26 November 2009 when £5,000 was paid. Cornerstone's PAYE tax and NIC liability for the tax year 2008/09 has been assessed at £126,677.86 of which £121,677.86 was still outstanding as at 6 September 2010.

On 28 June 2010, the Appellants were each disqualified from holding the office of director for a period of four years.

The Appellants sought to displace the PLN's on the basis that they were not neglectful, but the Tribunal gave their appeal short shrift. The decision records:

"We have, however, no difficulty in holding on the balance of probabilities, that Innova's failure to pay the NIC specified in the PLNs was attributable to the neglect on the part of the Appellants. HMRC have discharged the onus of proof which rested on them. It was plain that the Appellants were fully aware of the statutory obligations in relation to payment of NIC. They received information each month about the financial health of Innova including the amount of NIC due and payable by the 19th of the month. They were personally responsible for ensuring the payment of NIC and PAYE tax. They were responsible for the decision each month, while Innova traded, not to pay NIC and PAYE tax and chose instead to pay other creditors and their own salaries; they thus propped up for as long as possible an ailing business with funds which should have been remitted to HMRC. No attempt was made to discuss matters with HMRC. They made no reasonable provision for the payment of NIC or PAYE tax; even although they must have been aware that the liability to HMRC was increasing each month.

Having traded in the consultancy business for a number of years through the medium of Synergi, the Appellants were well aware of a company's statutory obligations in relation to the payment of PAYE tax and NIC. From the outset Innova was probably underfunded. If it was not, then one must ask why no PAYE tax or NIC was ever paid. It is no defence to say that HMRC were not chasing for payment. Innova had a statutory obligation to pay whether or not HMRC demanded payment sooner or later.

No reasonable and prudent businessman would have behaved in this way or conducted business in this manner. No reasonable and prudent businessman would have neglected to pay the NIC as it fell due. Any reasonable and prudent businessman, having control of the operations of Innova, would probably have ceased trading within a few months of start-up at the latest or attempted to make arrangements with HMRC about deferring payment."

*The test of 'neglect' - Appeal case: O'Rorke v HMRC TC01675*

This case is an appeal about a subsidiary aspect of the power in section 121C; it concerns whether medical evidence submitted at an earlier hearing should be allowed, and the key issue tested was whether the test of "neglect" in the legislation is an objective test or a subjective one. If the test is subjective, then evidence as to the defendant's state of mind at the time of the offence would be relevant to an appeal; if objective then the medical evidence would not be admissible.

Mr O'Rorke was the finance director of L Wear & Co; he resigned as a director on 22 February 2007. On 5 March 2007 the company went into liquidation owing £321,306.60 of unpaid NICs. On 3 September 2009 HMRC issued Mr O'Rorke with a PLN for £290,307.60, and on 25 June 2010 this was reduced to £218,593.77.

Mr O'Rorke appealed against the PLN on the basis that he suffered from an addiction which affected his behaviour, and this ought to be taken into account when assessing whether he was negligent in carrying out his duties.

HMRC argued that the test of negligence in s 121C was an objective test and thus the state of mind or mental capacity of the officer was irrelevant in determining his culpability for the failure of the company to pay. This therefore excluded the submission of medical evidence by Mr O'Rorke to support his claim that he was not culpable due to his state of mind brought about by his addiction. HMRC's view is based on the normal understanding of neglect in other areas of legislation. They claimed that there was no basis on which a different, subjective, interpretation could be based, and that the court was therefore obliged to follow the normal interpretation of neglect – this being an objective test. Had Parliament intended a different meaning to apply, then the law would have made this clear.

HMRC cited a number of cases to support their view, and most particularly *Peter Inzani v R & C Commrs* [2006] STC SCD 279, in which an earlier court definition of neglect set out in *Blyth v Birmingham Waterworks Co* (1856) 11 Exch 781:

'Negligence is the omission to do something which a reasonable man, guided upon those considerations which ordinarily regulate the conduct of human affairs would do, or doing something which a prudent and reasonable man would not do. The defendants might be liable for negligence if, unintentionally, they omitted to do that which a reasonable person would have done, or did that which a person taking reasonable precautions would not have done.'

Other cases were cited which also referred to Blyth. The Inzani case was a similar appeal against a PLN under s 121C, and another case cited was a 2011 appeal against a PLN – *Stephen Roberts & Alan Martin v R & C Commrs* [2011] UKFTT 268 (TC).

The Tribunal considered the matter in some depth and came to the conclusion that as s121C is a penal provision, the tribunal should be careful in how the legislation is construed. HMRC's view is that as the legislation is clear, the intention of Parliament expressed in Hansard is not relevant (*Pepper v Hart*). However in *J E Chilcott & Others v R & C Commissioners* [2009] STC 453, subsequently upheld by Lord Neuberger with the following:

'The fact that some might regard the operation of s144A, according to its terms as penal, merely emphasises that the court should construe it with care and if there is a narrower construction less beneficial to the Revenue, more beneficial to the taxpayer, available then the court should at least seriously consider it, and if appropriate, adopt it.'

The Tribunal decided to follow some of the matter quoted in Hansard, and found the test to be a subjective test, which must take into account the state of mind of the officers concerned.

Upper Tribunal appeal: *HMRC v O'Rourke* [2013] UKUT 0499

The Upper Tribunal overturned the decision of the First Tier Tribunal in the above case. The Tribunal Judge, Mr Justice Hildyard, found the concept a difficult one, but on balance could not find sufficient in the context of the legislation to support the displacement of the standard view of neglect as being an objective test.

*Appeal case: Michael Denmark v HMRC TC0696*

This is a routine appeal against a personal liability notice, but suggests that the powers in FA 2020 are well placed to deal with issues raised by this appeal.

Mr Denmark was the sole director of Worldwide Support Services Limited (WSSL). The company was incorporated in July 2012. It operated until it was voluntarily liquidated in December 2013. During this time, the company operated as a payroll services company, but made no payments to HMRC either of PAYE or of National Insurance Contributions. Payroll started in November 2012 but no 2012-13 P35 was filed; the company did file under RTI in 2013-14 for the time it was active. During the appeal it emerged that Mr Denmark was also a director of two other companies in liquidation owing money to HMRC. The total arrears of PAYE and NIC for the two tax years (but only just over 12 months of operation) were £1,359,870. A successor company WSS London Ltd went into liquidation in July 2014 owing HMRC £543,590 in PAYE and NIC – once again no payments having been made at all.

The appeal was dismissed. Mr Denmark was disqualified as a director for his conduct while a director of Worldwide Support Services Ltd though an undertaking given on 5 October 2015. He was further disqualified by court order on 2 March 2018 for conduct while a director of two further companies.

*Appeal case: Vinod Parmar & Bhwana Parmar v HMRC TC04927*

This case applied both the PAYE and NIC rules together to recover substantial sums from two company directors. The company records were poor to non-existent, and the directors took much of the company takings in cash for themselves, paying for personal expenditure and credit card bills. The amounts were not recorded as income of the company. The company was subsequently liquidated, and HMRC raised assessments on the two directors for PAYE on the amounts calculated as removed over a period of years, and issued personal liability notices for the related NIC.

The directors sought to argue that the amounts so taken should be regarded as dividends, as that was always their intention – to draw a modest salary (below the NI limit) and the balance by way of dividends. However, given that the amounts had not been included in the company accounts (nor was corporation tax paid on them) and there had been no director or shareholder meetings, this was an impossible claim.

The Personal Liability Notices were upheld.

*Contributed by Rebecca Benneyworth*

## Deadlines

### *1 October 2022*

- Corporation tax for periods to 31 December 2021 for SMEs not paying by instalments

### *5 October 2022*

- Notify income tax and CGT for 2021/22 if a tax return or notice to file not received

### *7 October 2022*

- VAT return and payment for 31 August 2022 quarter (electronic)

### *14 October 2022*

- Submit form CT61 and pay tax for quarter ended 30 September 2022
- Quarterly instalment payments for large companies depending on year end
- Monthly EC sales list (paper) –businesses selling goods based in Northern Ireland only

### *19 October 2022*

- PAYE/CIS liabilities for month ended 5 October 2022 (cheque)
- File monthly CIS return
- PAYE settlement agreement tax/ class 1B National Insurance (cheque) due
- Payment of PAYE for quarter to 5 October 2022 if average monthly liability < £1,500

### *21 October 2022*

- Online monthly EC sales list –businesses selling goods based in Northern Ireland only
- Supplementary intrastat declarations for September 2022
  - arrivals only for a GB business
  - arrivals and despatch for a business in Northern Ireland

### *22 October 2022*

- PAYE/CIS payments if paid online
- PAYE electronic payment for quarter to 5 October 2022 if average monthly liability < £1,500
- Electronic payment of PSA liabilities

### *31 October 2022*

- Submit 2021/22 paper Self Assessment tax returns
- Individuals with PAYE income must have requested a return for 2018/19

## Business Taxation

### Change for the bus (Lecture B1336 – 21.09 minutes)

*Summary – Takings were not being suppressed. It was reasonable to accept that the till was being opened by staff to provide bus passengers with change as well as a number of other legitimate explanations.*

Quality Convenience Store Limited was incorporated in 2016 selling groceries, tobacco, newspapers and other convenience store items. It also ran a post office branch within its premises.

Cash taken by the shop and banked was reconciled daily to till receipts. Till reports which identified the use to which the buttons on the tills had been put were available every day but were only checked when there was a problem.

HMRC conducted unannounced visits to the premises in December 2016 and March 2017. During this time the officer established that staff could, and often did, use the 'no sales' button to open the till and remove cash. In fact HMRC calculated that between 1 May 2016 and 30 April 2017 the no sale button was used on 22,580 occasions so in excess of 60 times a day.

The company explained that the no sale button was used to open the till:

- to provide change, particularly to schoolchildren, for the bus;
- to enter change into the till;
- for counting cash prior to handing over the till at a shift change;
- for counting cash following a shift change; and
- for counting cash at the end of the day.

Believing the use of the button to be excessive, HMRC raised VAT and corporation tax best judgement assessments on the basis that the company was suppressing sales. HMRC determined the average transaction value by taking the gross sales figure from audit trail reports provided, deducting Pay point and lottery income, and dividing the resulting figure by the number of transactions. This resulted in an average transaction value of £5.96. HMRC allowed a daily 'no sales' button usage of 16 and then calculated that between 1 May 2016 and 31 January 2018 the company had suppressed takings by £153,976.60.

Following HMRCs visits, staff were told that they should no longer use the 'no sales' button for providing change and that if people wanted change, they would have to purchase an item at the shop. Initially, staff switched to using the 1p sales button for the purposes for which they had previously used the no sales button but this was quickly rectified.

The company notified that despite not using these two buttons on the till, there had been no significant increase in the reported quarterly sales. In their defence, the company stated that:

- in the period ended 30 April 2018, the 'no sales' button was used 1,939 times and the 1p sales button 980 times, and turnover was approximately £224,999
- in the period ended 31 October 2019, the no sales button was used 55 times and the 1p sales button only twice, turnover was £225,233.

### *Decision*

The First Tier Tribunal accepted that HMRC's logic for raising the assessments was rational and valid but disagreed with the quantum of those assessments.

When presented with the company's later explanations and supporting figures, HMRC had produced little additional evidence to support their case.

The First Tier Tribunal concluded that on the balance of probabilities, the company's story was more likely to be correct.

It was clear from the facts that the shop was in an area surrounded by bus stops, and that it was perfectly plausible that the company provided change for those using the buses. HMRC's estimated usage allowance of 15 or 16 per day rather than the average of approximately 61 uses per day was an arbitrary figure. In light of the company's evidence, the Tribunal thought it more likely to be approximately 61 uses per day. Consequently, the First Tier Tribunal concluded the business had not suppressed takings.

The appeal was allowed.

*Quality Convenience Store Limited v HMRC (TC8530)*

## **SEISS to be repaid (Lecture B1336 – 21.09 minutes)**

*Summary – As the taxpayer incorporated his business just before the COVID lockdown, he was not entitled to sums paid under the Self-Employment Income Support Scheme.*

When Joshua Taylor filed his 2018/19 tax return in September 2019, he disclosed that he had ceased self-employment as a fitness trainer in July 2018. From that date, he had been employed by his company, Coach JT Limited.

On 14 May 2020, Joshua Taylor applied for the first Self-Employment Income Support Scheme grant and a payment of £2,426 was made on 18 May 2020.

On 20 August 2020, he applied for the second Self-Employment Income Support Scheme grant and a payment of £2,123 was made on 24 August 2020.

In October 2020, HMRC sent him an email stating that because he had not been self-employed, he was not eligible to receive a Self-Employment Income Support Scheme grant and that he needed to repay the money that he had incorrectly claimed.

In a telephone call that took place in February 2021, Joshua Taylor stated that he understood that to be eligible for the grant, the only criteria was that he had traded as a self-employed individual in the years 2016/17 to 2018/19.

HMRC explained that those were the years upon which the grant was calculated.

HMRC went on to say that as part of the claim process he was asked to confirm that he traded in 2019/20, intended to continue to trade in 2020/21 and the business had been adversely affected by Coronavirus. The taxpayer denied ever seeing the screens asking him to confirm these details. He argued that HMRC had full access to his tax returns and therefore could or should have checked that information before making the grants.

On 19 March 2021, HMRC issued the assessment to reclaim the sum of £4,549.

Joshua Taylor appealed.

### *Decision*

The First Tier Tribunal agreed that, at all relevant times, Joshua Taylor was a fitness coach. He was self-employed until the end of July 2018 and from then, he traded through a company.

Joshua Taylor was not eligible to make claims under the Self-Employment Income Support Scheme as he was not self-employed at the relevant time. The Tribunal stated that it was clear who was eligible for the grant, stating “Bluntly, the clue is in the name”. It was a grant for the self-employed.

For completeness, Joshua Taylor had claimed that HMRC had stated that they had checked his claim at a time when, had they looked at his Self Assessment returns, they would have known that he was trading through a company. The Tribunal stated that it had no jurisdiction in relation to matters of legitimate expectation. The facts were that Joshua Taylor did not qualify for support payments and in those circumstances the law gives HMRC the authority to raise an assessment. HMRC had raised a valid assessment within the applicable time limits.

The appeal was dismissed.

*Joshua Peter Taylor v HMRC (TC08576)*

## **Drawings, not deductible expenses (Lecture B1336 – 21.09 minutes)**

*Summary - There was no evidence that the expenses claimed were incurred, and even if they had been, they were not incurred wholly and exclusively for the trade but rather, they should be treated as drawings.*

For the years 2004/05 to 2014/15, the Magnet Partnership traded as Rope Access designers or Magnet & Rope Access Designers. Regardless of turnover, the partnership's profits for these years were precisely zero.

The partners were the Ian Fada Partnership, the Haritou Partnership, the Fada Partnership and the Rhodes Partnership. Collectively these were known as the “Family Partnerships”. All

commenced on 1 April 1999. None of these partnerships had a bank account. All income in each partnership was derived from Magnet.

The partners in Magnet had an annual meeting to determine how much each Family Partnership should receive for what was described as consultancy and design work. This income was then reduced by claiming estimated household and other private expenditure, including university costs for their children.

HMRC raised enquiries and issued discovery assessments for each year, denying that the expenses that had been deducted had actually been incurred, or alternatively that the expenses had not been incurred wholly and exclusively for the purposes of the partnership's trade. The direct costs paid to the family partnerships were in reality drawings by the partners.

The Magnet Partnership appealed.

### *Decision*

The First Tier Tribunal found that there was an absence of accurate evidence to support the partnership's deducted expenses. With no bank account, there was no evidence that the payments claimed were paid at all. The Tribunal concluded that even if the payments were paid, they would not be an allowable deduction as they were not incurred wholly and exclusively for the purposes of the trade.

The Tribunal concluded that the amounts paid to the 'family partnerships' were drawings making them not deductible.

The appeal was dismissed.

*The Magnet Partnership v HMRC (TC08570)*

## **Loss relief on business incorporation (Lecture P1338 – 9.48 minutes)**

### *Background*

The incorporation of a business involves the cessation of a former sole trader or partnership. There are many possible reasons why sole traders or partners may wish to transfer the trade or business to a company, which might be tax-related, commercial or both.

There is a specific relief from capital gains tax (CGT) on the incorporation of a business, where certain conditions are satisfied. This form of rollover relief of gains against the base cost of the former business owner's shares in the company (in TCGA 1992, s 162) is relatively well-known and widely used, particularly in recent years on the incorporation of rental property businesses.

However, there is a less well-known tax relief when a business is transferred to a company. This income tax relief (in ITA 2007, s 86) allows losses of the unincorporated business owner to be carried forward and offset against income that the individual receives from the company. This income tax relief, like CGT incorporation relief, is subject to certain conditions.

### *Relief conditions*

The relief may be claimed if four conditions are all met:

1. A trade is carried on by an individual, either as a sole trader or by individuals in partnership.
2. The trade is transferred to a company.
3. The consideration for the transfer is wholly or mainly the allotment of shares to the individual or individuals. However, HMRC's position is that where the consideration is expressed in the vending agreement to be cash, but the whole amount is subscribed for shares in the company, the shares may be regarded as the consideration for relief purposes (see HMRC's Business Income manual at BIM85060).
4. In the case of any individual to whom shares are allotted, that individual's total income for the relevant tax year includes income derived from the company.

If these conditions are all satisfied, for the purposes of carry-forward trading loss relief, the individual's income from the company is treated as trading profits of the relevant tax year carried on by the individual; or if the trade was carried on by the individual in partnership, their income from the company is broadly treated as the individual's partnership profit share.

The legislation states that the income derived from the company may be dividends on the shares or otherwise. The reference to 'or otherwise' is taken to mean remuneration, interest or rent, in addition to dividends.

The relief is available for the tax year in which the trade is transferred, if the individual is the beneficial owner of the allotted shares and the company carries on the trade up to 5 April in that tax year. Loss relief is also available in subsequent tax years if the same conditions are satisfied throughout the tax year.

Strictly speaking, all the allotted shares need to be retained. However, HMRC guidance states that in practice, relief should not be refused so long as the individual keeps shares representing more than 80% of the consideration received for the business.

It is helpful to note that this income tax loss relief applies not only to trades, but to businesses which are not trades (e.g., rental property businesses); so the relief is more flexible than the normal carry-forward trade loss rules (in ITA 2007, s 83), which apply to the offset of trading losses against income from the same trade carried on by the same person.

Having said that, the loss relief rules where a business is transferred to the company are concise and fairly prescriptive

### *Conditions not met*

In *Davis v Revenue and Customs* [2022] UKFTT 274 (TC), the taxpayer carried on a sole trade of providing finance for second-hand car sales. The only customer of the sole trade was named Dickinson. The sole trade operated by the taxpayer provided funds to Dickinson, who acquired second-hand cars. When a car was subsequently sold, Dickinson repaid the loan for buying the car and shared the profit on sale with the taxpayer.

A company ('USL') was incorporated in September 2005 and started trading in October 2005. The taxpayer made a cash subscription for 100 shares at £1 per share on the incorporation of USL. However, the shares were not issued to the taxpayer in consideration for the transfer of a trade to USL, and at the time of incorporation no physical assets were transferred from the taxpayer to USL. The final transactions in the taxpayer's sole trade were with Dickinson in November 2007 (i.e., more than two years after USL started to trade).

The trade carried on by USL related to the purchase and sale of second-hand cars, but the business structure was different from the taxpayer's trade, as USL bought the cars directly. The cars were then sold on to consumers by a range of third-party garages. When a car was sold, USL received the original purchase price of the car and a share of the profit made on the sale. Dickinson was never a customer of USL.

The taxpayer's loss arose because Dickinson defaulted on the contractual arrangements with the taxpayer on a number of occasions going back to 2002, whereby Dickinson would not pay the taxpayer either the capital or profit, or would only pay partially.

HMRC enquired into the taxpayer's tax returns for 2016/17 and 2017/18, and subsequently refused the taxpayer's claims to offset losses from his sole trade against income derived from the company (under ITA 2007, s 86).

On appeal, the First-tier Tribunal (FTT) found that no trade was transferred from the taxpayer to USL. The tribunal also found that the taxpayer's existing trade, being the second-hand car financing activities with Dickinson, continued to be operated by the taxpayer for two years after USL was incorporated. On the relief condition that the consideration for the transfer was wholly or mainly the allotment of shares, the taxpayer conceded that the shares were subscribed for by him in cash, and were not issued in consideration for the transfer of the trade. The taxpayer's appeal was dismissed.

#### *Alternative argument*

On the facts, the taxpayer's case was seemingly doomed. However, an interesting postscript to Davis is that the taxpayer's representative put forward an alternative argument, which was broadly that the tribunal should take a purposive approach to interpreting the loss relief provisions and allow relief on that basis. This was a kind of 'reverse Ramsay' approach. The 'Ramsay principle' is relatively well-known and is broadly concerned with taking a purposive approach to countering tax avoidance.

Unfortunately for the taxpayer, whilst this argument by Mr Davis's representative was innovative, the tribunal held that the facts did not match up with such an approach, because no trade was actually transferred.

*Contributed by Mark McLaughlin*

## **Christmas Spectacular**

*Summary – The Christmas spectacular show was a production that qualified for theatre tax relief.*

Thursford Enterprises Limited held its Christmas Spectacular show in Norfolk and claimed theatre tax relief.

To qualify for this relief a production must consist of 'a play, opera, musical or other dramatic piece that tells a story, where the performances are live and the performers give their performances wholly or mainly through the playing of roles'

HMRC refused relief on the basis that the show was not a 'dramatic piece' but was more like a variety show where each participant performed as themselves. HMRC argued that to be a dramatic piece, the company needed evidence of a storyline that could be clearly followed through the characters.

Thursford Enterprises Limited appealed, claiming there was no statutory requirement to have a narrative and that none of the artistes were performing as themselves.

### *Decision*

After watching a video of the show and hearing extensive evidence, the First Tier Tribunal found that the audience was taken on 'an imaginative journey of Christmas memories'. As such it was a dramatic piece. The singers and dancers were not 'simply performing as themselves'.

The performance was mainly through singers and dancers playing roles; while some performers – the musicians – were not playing roles, about 80 out of a cast of 112 members were acting out characters.

The First Tier Tribunal concluded that the production qualified for theatre tax relief.

The judges described HMRC's contention that such a decision would open the floodgates, allowing the Royal Variety Performance, pop concerts and karaoke productions to be entitled to relief, as hyperbole.

They said the Royal Variety Performance was a collection of individual acts, although it conceivably could qualify for the relief if the production was mainly performed through the playing of roles. A pop concert may have dramatic effects, but it was unlikely to present a dramatic illusion and karaoke was 'unlikely to be a theatre production never mind dramatic'.

The appeal was allowed.

*Thursford Enterprises Limited v HMRC (TC8560)*

*Adapted from the case summary in Taxation, 18 August 2022*

## **Avoidance of tax was not a main purpose**

*Summary – The share exchange scheme was undertaken for bona fide commercial reasons, meaning that the reorganisation provisions applied.*

Euromoney Institutional Investor plc owned shares in a company which it sold to another unconnected company, DTL. In consideration it received ordinary shares and \$1 redeemable preference shares in DTL.

The intention was to treat the entire transaction as a share for share exchange under s.135 TCGA 1992, with the capital gain on the disposal of shares rolled over into the ordinary and preference shares. After a year, when the preference shares were sold or redeemed, the disposal would qualify for substantial shareholding exemption (SSE)

HMRC considered the main purpose or one of the main purposes of the arrangements was to avoid tax and issued assessment to corporation tax.

The First Tier Tribunal had allowed the company's appeal, saying the avoidance of tax was not a main purpose.

HMRC argued that the First Tier Tribunal had applied the wrong test in determining whether the exchange was part of a scheme or arrangements.

The parties agreed that if s.137 TCGA 1992 was engaged then share for share treatment would not apply to the entirety of the exchange, including the element involving ordinary shares.

### *Decision*

The Upper Tribunal said it was a question of fact for the First Tier Tribunal to determine the extent of the 'scheme or arrangements' for the purposes of the anti-avoidance rule. It was entitled to conclude that a consideration of Euromoney's subjective purposes was at the heart of the analysis since the initiative for the creation of the preference shares came from Euromoney.

The Upper Tribunal also disagreed with HMRC that the First Tier Tribunal had erred in law in its determination of the arrangements. The judges noted that HMRC had asked the First Tier Tribunal to look beyond the taxpayer's witness statements to cast light on the subjective intentions of the taxpayer. Having taken into account such additional evidence, it was reasonable for the First Tier Tribunal to conclude that the relatively modest size of the tax advantage viewed in the context of the deal as a whole was relevant and that this suggested that avoidance of tax was not a 'main purpose'.

HMRC's appeal was dismissed.

*HMRC v Euromoney Institutional Investor plc [2022] UKUT 00205 (TCC)*

*Adapted from the case summary in Taxation (18 August 2022)*

## **Withholding tax exemption**

*Summary – The company was entitled to the exemption from UK withholding tax under the UK/Ireland double tax treaty because neither the Cayman seller nor the Irish buyer had a main purpose of taking advantage of the withholding tax exemption provided by the treaty.*

Following the collapse of Lehman Brothers International (Europe) (LBIE), a secondary market for its debts developed. In this case, LBIE debt was assigned by a Cayman Islands company (SICL), by then in liquidation, to the appellant, an Irish tax resident company (BLM), through an intermediate assignment to a broker retained by SICL's liquidators to market the debt claim. Since the £142m principal had already been repaid by LBIE's liquidators to SICL, the debt which was assigned comprised outstanding statutory interest of £90.7m. UK income tax of £18.15m was withheld on the interest payments to BLM.

The dispute was whether BLM could recover the tax under the UK/Ireland double tax treaty, which (under article 12(1)) provides Irish tax resident recipients with full relief from UK withholding tax on interest.

This was subject to an anti-avoidance provision in article 12(5), which (as it then stood) required that no person concerned with the assignment of the debt claim had a main purpose of taking advantage of the double tax treaty exemption by means of that assignment. HMRC refused BLM's repayment claim, arguing that the anti-avoidance provision applied.

### *Decision*

The First Tier Tribunal decided that neither BLM nor SICL had a main purpose of taking advantage of the UK withholding tax exemption in article 12(1) of the UK/ Irish double tax treaty for itself. Therefore, BLM was entitled to a full refund of the withheld UK tax.

In concluding that BLM didn't have a main purpose of taking advantage of the UK withholding tax exemption in the double tax treaty, the First Tier Tribunal distinguished between BLM's purpose for purchasing the debt ('to realise a profit by reference to the difference between its purchase price and the cash flows that it received as a result of its acquisition of the relevant claim') and BLM's implicit understanding of the consequences of that purchase (that UK withholding tax was not a permanent cost because of its Irish tax residence).

BLM's ability to receive UK source yearly interest without UK withholding tax was 'the setting' in which BLM made its offer for the debt claim. Taking this attribute into account when considering the price of the debt did not mean that obtaining that benefit was one of BLM's main purposes in acquiring the debt, any more than it was when BLM acquired any other debt from other LBIE creditors (which HMRC had not challenged).

Further, SICL didn't have a main purpose of taking advantage of the UK withholding tax exemption in the double tax treaty. Here, the First Tier Tribunal distinguished between:

- cases where the resident in the non-double tax treaty jurisdiction 'retains an indirect economic interest in the debt claim generating the flow of income which passes through the person claiming the benefit of the [double tax treaty]', in which case the non-treaty party 'takes advantage' of the double tax treaty by accessing it indirectly (i.e. treaty shopping); and
- cases, such as this one, where a debt is sold outright so the seller doesn't retain any ongoing economic interest in the flow of income from the debt, even if the sale price reflects the tax attributes of the purchaser (in which case the seller would not normally be 'taking advantage' of the double tax treaty).

*Burlington Loan Management DAC v HMRC (TC08572)*

*Adapted from the case summary in Tax Journal (9 July 2022)*

## **Relief for foreign tax suffered (Lecture B1339 – 22.44 minutes)**

### *Types of foreign tax*

#### Underlying tax

Foreign profit-based tax, e.g. on branch profits, some other PE in that country.

Underlying tax is also deemed to arise on taxable foreign dividends, if the company controls at least 10% of the voting power of the paying company.

In practice, virtually all foreign dividends received by a UK company are exempt from corporation tax, so the underlying tax is not considered.

### Withholding tax

The payer must retain local tax at source and pay it to its tax authority and then it pays the net amount to the UK company

### *Credit relief for foreign tax*

A double tax credit may be provided for in a double tax treaty (see later). If not, UK law gives the right to unilateral double tax relief (ss9 – 17 TIOPA 2010) unless expressly prohibited in a double tax treaty (s11(3)).

A claim for credit relief must be made not more than—

- a) 4 years after the end of that accounting period, or
- b) if later, one year after the end of the accounting period in which the foreign tax is paid (s19(3) TIOPA 2010)

Treaty reliefs must be claimed, they are not automatic. For double tax credits this can be done in the CT600.

For withholding tax relief (to minimise the amount deducted), a claim must be made before the relevant payment is made by the payer.

Unilateral relief should be claimed in the CT600, but it is best practice to write to HMRC to confirm that the relief will not be challenged.

Boxes 450, 455 and 460 of the CT600 deal with the amount of double tax relief claimed, whether this includes a claim for underlying tax and whether the claim includes amounts carried back from a later period (as can be the case if the foreign income is from a foreign permanent establishment of the company).

### *Treaty and unilateral relief*

Relief is claimable for the taxes covered by a particular tax treaty

### *Example*

UK-Italy double tax treaty

- Article 2(1)(a)
  - UK (income tax, capital gains tax,) corporation tax and petroleum revenue tax

- Article 2(1)(b)
  - the personal income tax (l'imposta sul reddito delle persone fisiche);
  - the corporate income tax (l'imposta sul reddito delle persone giuridiche);
  - the local income tax (l'imposta locale sui redditi);
  - whether or not collected by withholding at source

But what is the situation for other foreign (in this case, Italian) taxes suffered?

Article 2(2) states that

“This Convention shall also apply to any **identical or substantially similar taxes** which are imposed by either Contracting State **after the date of signature of this Convention** in addition to, or in place of, the taxes of that Contracting State referred to in paragraph (1) of this Article”

*Example – IRAP (Imposta Regionale sulle Attività Produttive)*

This is an Italian regional tax on production activities. It is a local tax collected by the Region where the production activities liable for tax are conducted.

The standard rate is 3.9% with higher rates for banks and insurance activities and the rate is broadly based on gross margin.

Is this substantially similar to taxes covered in Article 2(1) and was it created after the treaty was signed?

It does not seem to be substantially similar to corporate income tax which is based on total profits chargeable to tax.

In this case, the company should write to HMRC and ask it to confirm that the tax is eligible for unilateral tax relief.

In this case, HMRC replied stating that:

“It is HMRC’s position that the Imposta Regionale Sulle Attività Produttive (“IRAP”) is not a covered tax under the UK-Italy Double Taxation Convention.

However, in line with HMRC Statement of Practice 7/91, we do accept that IRAP is admissible for unilateral double tax relief under section 9 of the Taxation (International and Other Provisions) Act 2010. (Guidance on this can be found in HMRC’s manuals at INTM161030.)

This relief can be claimed in the Corporation Tax return in the same way as treaty DTR - I would recommend including a note explaining the unilateral basis of the DTR”

*When double tax credit is not allowed*

TIOPA 2010 sets out various situations where a double tax credit cannot be claimed.

1. The foreign tax has been relieved against overseas tax (s25 TIOPA)
2. The company is non-UK resident for tax purposes (s26 TIOPA)
  - Unless the credit is sought by a company resident in the Isle of Man or Channel Islands
3. The person elects for the credit to not be allowed against the tax on the foreign income (s27 TIOPA) - Claiming expense relief instead, for example
4. Credit relief cannot exceed the credit that would have been allowed had all reasonable steps been taken under foreign law or the DTT to minimise the amount of tax payable in the foreign territory (s33)
  - E.g. claiming the benefit of reliefs from tax, making elections
5. Any disallowed credit can be deducted against the foreign income chargeable to UK tax (s35)
  - Includes foreign tax in excess of the limit of credit relief (s42(2))
  - Limit =  $R \times IG$  (CT rate x amount of income/gain chargeable)

#### *Example*

ABC Limited is UK resident

It has UK income of £1,200,000 and foreign income of £500,000 of which 25% foreign tax has been deducted at source.

Explain how the company will obtain relief for the foreign tax

#### *Analysis*

The double tax credit will be allowed up to a maximum of  $19\% \times £500,000$ , i.e. £95,000

The excess foreign tax that does not get credit relief (£125,000 - £95,000) £30,000 is deductible against the company's total income.

The final CT payable will be:

- UK profits
- Foreign income
- Minus: Excess foreign tax

Profit chargeable

Corporation tax @ 19%

Minus: Double tax relief

### **UK tax payable**

#### *Foreign income where loss relief is available*

If a company has foreign income with tax suffered at source, but also has (say) trading losses, its total income could be reduced to zero and it would get no credit relief for the foreign tax suffered.

If the loss relief is current year or carry back relief, the maximum possible loss must be used. To avoid wasting relief for the foreign tax credit, the company can claim expense relief for the foreign tax.

#### *Example*

XYZ Limited has foreign income of £200,000 from which 10% foreign tax has been withheld.

It also has a current year trading loss of £350,000 and no other income nor gains.

The foreign income is reduced to zero if the company makes a current year loss claim, so the £20,000 foreign tax could not be credited as there is no UK liability.

The company can claim to deduct the £20,000 tax from the foreign income, reducing it to £180,000

This means that it only needs to use £180,000 of its current loss in the current year claim leaving more loss to either carry back or carry forward.

#### *Time limit for claiming expense relief?*

The legislation does not seem to require a formal claim for expense relief. This might mean that it follows the normal rules for amending the CT return, being 12 months after the due filing date (24 months after the end of the relevant period).

What if a company has claimed credit relief in its year ended 31 December 2018, but a later loss arises in the year ended 31 December 2021, which can be carried back under the Covid-19 extension 3 years and reduces the profits of year ended 31 December 2018 to nil?

In hindsight the company would have been better to use expense relief for the foreign tax suffered rather than a double tax credit.

But would it be permitted to amend the return as it is now more than 24 months from the year end?

If the use of expense relief follows the normal amendment window, it appears not, but what we would be doing is reversing the claim for credit relief (for which there is a 4-year window). So it does seem possible in principle to make a claim to use expense relief with hindsight.

*Contributed by Malcolm Greenbaum*

## VAT and indirect taxes

### No refunds actually made (Lecture B1336 – 21.09 minutes)

*Summary – There was no legal basis for a VAT repayment because the credit notes issued did not result in a reduction in the amount paid by the customers.*

London School Of Accountancy and Management Limited was incorporated on 26 June 2003 and provided higher education services to students on a commercial basis. The supplies of tuition were standard rated while the associated course materials were zero rated.

Typically, students prepaid some or all of the fees for tuition and course materials and invoices were issued accordingly.

In October 2012, as a result of commercial difficulties, the company entered administration and in June 2013, moved from administration to a creditors' voluntary liquidation.

Between April and June 2015, the joint liquidators created 'credit notes' for supplies made to around 4,000 former students, which were backdated to 30 September 2012. However, there were no repayments of the amounts in the 'credit notes'. Indeed, the liquidators indicated that former students were unlikely to receive refunds for their fees paid.

On 25 June 2015, a final VAT return was submitted by the liquidators for the period ending September 2012, which included an adjustment to reduce output tax by £782,505.76. The liquidators argued that as no services had been provided to the students, the VAT on the prepaid sums was repayable.

HMRC denied the claim, arguing that London School of Accountancy and Management Limited had received consideration for the courses and had made no refunds. There had been no price reduction.

#### *Decision*

Agreeing with HMRC, the First Tier Tribunal found that the credit notes were 'purely theoretical'. As there had been no refunds, or decrease in consideration, no output tax adjustment was available.

The appeal was dismissed.

As Neil Warren was quoted as saying in 'Taxation':

*"The VAT legislation is very tight to ensure there is fairness in the system .... to prevent a situation where a business or entity can charge £100 plus £20 VAT, get paid £120 by a customer – and somehow wriggle out of paying the £20 VAT to HMRC. This verdict was a victory for the integrity of the VAT system."*

*London School Of Accountancy and Management Limited v HMRC (TC08559)*

## Prison healthcare (Lecture B1336 – 21.09 minutes)

*Summary – The prison healthcare service provided to a number of prisons in England was a single composite supply, wholly exempt from VAT.*

Spectrum Community Health CIC supplied a range of healthcare services and related goods to prisoners in thirteen prisons in England. The services were supplied to NHS England under NHS Standard Contracts.

The services provided included medical care, the provision of prescription drugs and the supply of non-prescribed sexual health products. Some services were sub-contracted to third parties.

Under the contract, a single annual sum was paid, in monthly instalments. There was no individual service breakdown required.

It was common ground that Spectrum Community Health CIC made exempt supplies of medical care but Spectrum Community Health CIC also argued that when:

- dispensing prescription drugs, it made zero-rated supplies (Item 1, Group 12, Schedule 8 VATA 1994); and
- supplying non-prescribed sexual health products it was making reduced rate supplies (Item 1, Group 8, Schedule 7A VATA 1994).

Consequently, Spectrum Community Health CIC argued that it was required to be registered for VAT and was entitled to recover input tax attributable to its taxable supplies.

HMRC disagreed, arguing that the supplies were a single composite supply of care and/or medical treatment and, in connection with it, the supply of goods in or by a state-regulated institution. As a result:

- the supply was wholly exempt (Item 4, Group 7, Schedule 9 VATA 1994);
- VAT registration was not possible and no input tax could be reclaimed.

Spectrum Community Health CIC argued that if they were wrong, and this was a composite supply then it was exempt Item 1, rather than Item 4, as contended by HMRC.

Being exempt under Item 1 would mean that the supply of drugs and contraceptive products would be excluded from the supply and subject to VAT. This is on the basis that “These products are not strictly necessary at the time that the medical care is provided and are physically and economically dissociable from the supplies of medical care.”

### *Decision*

The First Tier Tribunal found that Spectrum Community Health CIC made a single composite supply of medical care. It did not make separate taxable supplies of drugs or contraceptive products.

The First Tier Tribunal did not accept that Spectrum Community Health CIC was a state-regulated institution, similar in nature to a hospital or centre for medical treatment or diagnosis. Consequently, they did not meet the criteria for Item 4.

Moving to exemption under Item 1, the First Tier Tribunal stated that this required the provision of services by registered medical and paramedical practitioners. Spectrum Community Health CIC employed relevant professionals including doctors, nurses to supply their services meaning their supplies were exempt under Item 1. Article 132(1)(c) extended the exemption to cover supplies of goods that were strictly necessary at the time of the provision of medical care and that were physically and economically indissociable. The First Tier Tribunal did not agree with the taxpayer's argument that the exemption did not extend to the provision of drugs and contraceptive products. As a result, Spectrum Community Health CIC was not entitled to be registered for VAT and its appeal was dismissed.

*Spectrum Community Health CIC v HMRC (TC08557)*

### **No valid invoice, no claim (Lecture B1336 – 21.09 minutes)**

*Summary – With both the lease agreement and lease rental invoices in the name of the sole trader, input VAT included on rental amounts paid by the company were not reclaimable.*

Mr Latifi ran a bed and breakfast business but was not registered for VAT.

In August 2013, he entered into a lease agreement with Oxford City Council, for quarterly rental amounts of £8,750.00, plus standard-rated VAT.

On 27 November 2013, his business was incorporated and the company registered for VAT.

Star Services Oxford Limited accounted for and claimed input VAT on the rent paid to Oxford City Council.

In June 2018 following a compliance visit, HMRC raised an assessment on Star Services Oxford Limited for £26,250. This covered the three-year period from 2014 to 2017 and related to the input tax incorrectly reclaimed on the rent paid to the council. HMRC stated that the VAT could not be reclaimed as the lease and invoices raised were to Mr Latifi and not the company.

Prior to HMRC raising this assessment, Mr Latifi had registered for VAT in his own name and applied for an option to tax (OTT).

#### *Decision*

The First Tier Tribunal agreed with HMRC.

Mr Latifi and the company were separate legal entities, needing separate VAT registrations.

The First Tier Tribunal found that it was Mr Latifi who had the lease with Oxford City Council and not his company. He was not registered for VAT at this time and so could not consider recovering the VAT.

Mr Latifi had effectively subleased the property to Star Services Oxford Limited which was an exempt supply. Input VAT on the invoice from Oxford City Council to Mr Latifi could not be recovered by a third party.

Note: At the time the assessment was raised, the HMRC officer commented:

“...a belated OTT has been applied for on the sole proprietor registration, & if that is granted in the future following provision of information requested, then any appropriate claim to input tax on the rent that may then be charged by the sole proprietor registration, can be made on a future return as appropriate.”

The issue in this appeal could have been avoided if Mr Latifi had been VAT as a sole trader, he had opted to tax the property and then charged VAT on the rent to Star Services Oxford Limited and the other tenants.

*Star Services Oxford Limited v HMRC (TC08573)*

### **Food split (Lecture B1336 – 21.09 minutes)**

*Summary – The company failed to produce satisfactory evidence that HMRC’s best judgement assessments were excessive,*

Peppermint Foods Limited ran two Essex-based Subway franchises. At both locations the company sold:

- hot toasted sandwiches; and
- cold food and drink.

Hot takeaway food as well as everything eaten on the premises was standard rated. Cold takeaway food, other than confectionary, should have been zero rated.

During an investigation, an experienced HMRC officer found that the average standard rated sales for the preceding four years was 58% which, in his experience, seemed low compared to other Subway franchises

As a result, in June 2018, he carried out a series of test purchases on two days at both venues. He discovered that items were being incorrectly recorded. In August 2018, HMRC shared the results of these test purchases with the company and was told that there had been some issues with the till which had been rectified. To check this, HMRC followed up their work by analysing Z-readings provided by the director for that month. This indicated that 78% of sales were standard rated. However, a further two days of invigilation checks were carried out in October 2018 and January 2019, which indicated that 94% of sales were standard rated.

HMRC concluded that Peppermint Foods Limited’s staff had incorrectly rung hot takeaway food into the till as cold takeaway food resulting in an underpayment of output VAT. Consequently, for the VAT periods 05/15 to 02/19, HMRC raised assessments to collect output VAT due, initially calculated using the 94% rate that they had arrived at. This was later reduced to 86%, an average of the 78% and 94% rates. A final reduction was made to the amount assessed to recognise that the assessment for the June 2015 period was out of time.

By the time of the hearing, Peppermint Foods Limited were disputing assessments totalling £144,383 of VAT due. Peppermint Foods Limited argued that the invigilation exercises carried out by HMRC were ‘wholly unrepresentative of the overall period assessed’. The company argued that HMRC should have undertaken a year of daily invigilations. Further,

HMRC did not allow for staff errors, for the times during which the ovens were unavailable and gave no consideration to IT errors.

### *Decision*

The First tier Tribunal concluded that HMRC's approach was evidence-based and took into account the impact of what might have been higher sales of cold food during the hotter month of August. In their view, the assessment was made to best judgment and was a valid assessment.

Having confirmed that the assessments raised were valid, the First Tier Tribunal then looked to the company to provide evidence to establish the correct amount of tax due. The tribunal stated that it was not for HMRC to 'conduct a year-long invigilation exercise', but rather was up to Peppermint Foods Limited to demonstrate that HMRC assessments were excessive. Indeed, the First Tier Tribunal was critical of the company for failing to provide 'contrary number evidence' to HMRC's figures.

The appeal was dismissed.

*Peppermint Foods Limited v HMRC (TC08553)*