

Personal tax update (Lecture P1396 – 21.04 minutes)

Directors' payments and RTI returns

Summary – Payments made to a director should have been reported for RTI purposes as he was an officeholder and employee.

John McDonald was the single shareholder/ director of Purple Sunset Limited.

In the years before 2018/19 he reported employment income received from the company in his Self Assessment return but the company neither paid national insurance contributions nor filed Real Time Information returns.

In December 2018, HMRC carried out a compliance visit and issued NIC assessments totalling £37,785.44 for the four years through to 2017/18, and penalties totalling £3,300 for failing to file RTI returns for 2015/16, 2016/17 and 2017/18.

Purple Sunset Limited accepted the NIC assessments but appealed the RTI penalties arguing that John McDonald did not have an employment with the company. As a director receiving money in that capacity, there was no requirement to file RTI returns.

It was common ground that the payments were not dividend income.

HMRC argued that:

- the PAYE Regulations 2003 require RTI returns be made for all employees;
- the term “employee” in those regulations is defined by reference to the same word in s.5 ITEPA 2003;
- that section provides that the term “employee” includes office holders; and
- directors are officer holders.

Decision

The First Tier Tribunal found that:

- as a director, John McDonald was an office holder;
- under s.5 ITEPA 2003, the term ‘employee’ includes office holder;
- the PAYE Regulations impose an RTI obligation for all employees.

As a result, the company was required to complete RTI returns for John McDonald.

The Tribunal found that the company did not have a reasonable excuse for failing to file RTI returns as ignorance of the law did not provide a reasonable excuse.

Purple Sunset Ltd v HMRC (TC08880)

Statutory residence test

Summary – A taxpayer who exceeded the permitted UK days for the statutory residence test by 5 days was UK resident. Caring for her ill twin and her twin's minor children did not represent exceptional circumstances.

On 4 April 2015, the taxpayer moved from the UK to Ireland and in 2015/16:

- her husband transferred shares to her and she received roughly £8 million dividend income;
- she completed her 2015/16 tax return on the basis that she was non-UK resident, meaning that the dividend income was not taxable.

Following an enquiry, HMRC believed that she had exceeded the permissible 45 days, making her UK resident. Consequently, HMRC issued an amendment to her return to collect additional tax of £3.1 million.

The taxpayer appealed to the First Tier Tribunal.

It was common ground that:

- she had been in the UK for 50 nights in the relevant year; five days more than the 45 days allowed under the statutory residence test;
- she would be UK resident for the relevant year unless the extra five days satisfied Sch 45, para 22(4) FA 2013 which provides that a day is ignored for the purposes of the statutory residence test day count in relation to a person if:
 - they would not be present in the UK at the end of that day but for exceptional circumstances beyond their control that prevents them from leaving the UK, and
 - they intend to leave the UK as soon as those circumstances permit.

The taxpayer argued that she satisfied the 'exceptional circumstances' rule as she was in the UK because her twin sister, who suffered from alcoholism and depression, had threatened to commit suicide and she was prevented from leaving the UK until the sister was "in a place of safety" and her minor children were being looked after.

The First Tier Tribunal rejected the 'place of safety' argument as the taxpayer's evidence as to the risk of her sister committing suicide lacked credibility. However, the Tribunal allowed the appeal stating that:

"the combination of the need for the Taxpayer to care for her twin sister and, particularly, for her minor children at a time of crisis caused by the twin sister's alcoholism does constitute exceptional circumstances"

The First Tier Tribunal accepted that she was the only person able to assist her twin sister at the time and was under a moral obligation to do so.

HMRC appealed to the Upper Tribunal.

Decision

The Upper Tribunal disagreed with the First Tier Tribunal, finding that exceptional circumstances for being prevented from leaving the UK could be met by a moral or conscientious inhibition on the taxpayer. Moral obligations are not exceptional but merely part of normal family life.

Further, the First Tier Tribunal had failed to apply each element of the statutory residence test to each of the five extra days that the taxpayer remained in the UK. It was necessary to find the facts for each condition and each day, which the Tribunal had not done.

The Upper Tribunal found that alcoholism was not an exceptional circumstance and so neither was caring for someone suffering from it. Her position was no different to other families dealing with the distress caused by alcoholism.

It considered that the circumstances which the taxpayer found when she visited her sister were not exceptional.

HMRC's appeal was allowed.

HMRC v A Taxpayer [2023] UKUT 00182 (TCC)

Note: The Upper Tribunal set out an approach which could be taken in future cases which is outlined below.

Consider separately each of the days for which the taxpayer is claiming to have met the exceptional circumstance requirements then for each of those days establish the facts which the taxpayer asserts relate to each of the five elements of the statutory test, the burden being on the taxpayer, namely that:

1. The circumstances were exceptional.
2. The circumstances were beyond the taxpayer's control.
3. The taxpayer would not have been present in the UK at the end of that day but for those circumstances.
4. The circumstances prevented the taxpayer from leaving the UK.
5. The taxpayer intended to leave the UK as soon as those circumstances permitted.

Establish the facts which the taxpayer asserts show that the circumstances changed so as to allow the taxpayer to leave the UK after the end of the relevant day or days; this will shed light on whether the taxpayer was previously prevented from leaving by the exceptional circumstances.

Consider which facts are objectively proven, either by documents or credible oral evidence, or by both.

In the light of those proven facts, decide whether each of the statutory requirements has been satisfied.

No exemption from HICBC

Summary –The taxpayer was liable the High Income Child Benefit Charge for the relevant years. However, the taxpayer had a reasonable excuse, meaning that the penalties were cancelled and two year’s assessments were out of time.

In 2000, Ms A and her then partner had a son and she claimed Child Benefit in respect of her son. Her understanding, which was correct at the time, was that all parents were entitled to Child Benefit when they had a child, and its receipt had no tax consequences.

On separation from her partner, Ms A retained custody of their son, her partner was required to pay child support and she continued to claim Child Benefit

Ms A began a relationship with Stephen Lee, and in 2006 they had a daughter. Her Child Benefit claim was increased to reflect her second child and the money continued to be paid into her bank account. From the evidence it was clear that the couple lived together at the same address but kept their financial affairs separate. Neither knew how much the other earned, and Stephen Lee did not know Ms A was receiving Child Benefit.

Stephen Lee completed Self Assessment returns for 2012/13 to 2015/16 showing that he was not a higher rate taxpayer so could not be liable for the HICBC introduced in 2013. Since the couple were not high earners, HMRC did not send them information about the new high income child benefit charge at that time.

HMRC removed the requirement for him to submit Self Assessment tax returns for 2016/17 on the grounds that he was employed and all his income was dealt with under PAYE.

However, in 2016/17 his earnings exceeded £50,000, the HICBC threshold, and it remained over that threshold for subsequent years.

In 2019, HMRC sent Stephen Lee a nudge letter about the HICBC. Ms A cancelled her claim and as HMRC did not explain that she should check the position for previous years, the couple thought the matter had been dealt with.

Later, in May 2022, Stephen Lee was assessed to the HICBC for 2016/17 through to 2019/20 as well as penalties for his failure to notify his liability to the charge.

Stephen Lee appealed and requested HMRC reverse the assessments under ESC A19 which begins:

“Arrears of income tax or capital gains tax may be given up if they result from HMRC’s failure to make proper and timely use of information...”

HMRC rejected the claim stating that it did not apply.

Decision

The First Tier Tribunal found that Stephen Lee had a reasonable excuse for failing to notify his liability as:

- he would never have been received the 2013 publicity about the HICBC when it was introduced as it was not relevant to the couple at the time;

- the 2019 nudge letter did not explain that simply cancelling the claim going forward was not enough; the couple needed to consider whether the charge applied in earlier years.
- a reasonable person who was informed by his partner that they had spoken to HMRC and the matter had been dealt with, would have taken no further action.

Consequently, the First Tier Tribunal cancelled the penalties.

Having found that Stephen Lee had a reasonable excuse, HMRC were restricted to going back four years instead of six as Stephen Lee had not acted carelessly. The assessments for 2016/17 and 2017/18 were out of time.

The assessments for the two later years were upheld as:

- his adjusted net income exceeded £50,000;
- he was the partner of someone who had claimed to Child Benefit;
- he was the higher earner of the two.

The First Tier Tribunal found that that there were no exemptions where the parent is not the biological parent or where child support is paid by another for that child.

Finally, the First Tier Tribunal found that HMRC were wrong to say that ESC A19 did not apply. HMRC were using both Ms A and Stephen Lee's income and child benefit information on file to identify them as relevant parties to receive the nudge letter sent.

However, the Tribunal had no jurisdiction to take this matter further. Stephen Lee should make a formal complaint to HMRC and the information to do so was provided to him.

Stephen Lee v HMRC (TC08872)

CGT law knowledge lacking

Summary – Payments made to redeem a mortgage and under a personal guarantee were not deductible for CGT and no Entrepreneurs' Relief was available.

In January 2017, John and Janet Beesley submitted their Self Assessment tax returns for 2015/16 but these did not include any information relating to CGT disposals.

Based on Valuation Office information, HMRC believed that the couple had sold a property in October 2015 and issued an Information Notice requiring the full information to be lodged by 22 July 2018.

The couple's agent replied promptly stating that the property had been "sold for the sole purpose of repaying a personal guarantee" and that he was chasing up the documents needed with solicitors.

On 10 August 2018, HMRC requested a CGT computation for the disposal and allowed an additional 30 days to provide the information from the solicitors.

On 3 October 2018, the agent sent HMRC a CGT computation showing a sale price of £395,037 and deductions of:

- a “Redeem Mortgage” figure of £186,345;
- a “Personal Guarantee” of £152,016;
- legal fees and agent’s commission.

For each taxpayer, the net gain was stated to be £17,779.50, with CGT payable calculated at 10% as entrepreneurs’ relief was claimed.

HMRC disallowed the deductions for both the mortgage redemption and the personal guarantee.

Although HMRC suggested that relief for loans to traders might be available for the guarantee, this was not supported by suitable evidence.

HMRC produced an amended CGT computation showing two gains of £134,945, assessments were raised and penalties charged.

After much correspondence between the parties lasting approximately one year, the Beesleys appealed.

Decision

The First Tier Tribunal stated that it was clear that ‘the agent has never understood the basic principles of capital gains tax’. S.38 TCGA 1992 is clear and provides that the only deductions from proceeds of a sale are the purchase price together with incidental costs of purchase, the incidental costs of sale and the amount of any expenditure wholly and exclusively incurred on enhancing the property. Consequently, HMRC was correct to disallow the mortgage redemption fee.

With no evidence supplied to support a claim that personal guarantee payment was a qualifying loan for relief for loans to traders, this deduction was also disallowed.

The Tribunal agreed that the agent had offered ‘absolutely no evidence’ to support a claim for entrepreneurs’ relief.

Having confirmed that HMRC’s computations and assessments were correct, the Tribunal moved on to consider the penalties. The Tribunal found that the taxpayers’ behaviour was careless and there was no reasonable excuse as they:

- had never cooperated with HMRC;
- should have been aware of the gain and questioned the need to report it for tax purposes.

The appeal was dismissed.

John and Janet Beesley v HMRC (TC08871)

Share exchange scheme

Summary – The main purpose of the share arrangement was to realise the value in the family business; it did not form part of a scheme or arrangement of which the main purpose, or one of the main purposes, was the avoidance of a liability to CGT. As a result, the share for share rules contained within s.135 TCGA 1992 applied.

Mr and Mrs Wilkinson owned about 58% of the ordinary shares in P Ltd.

A few days prior to the shares for share deal detailed below, Mr and Mrs Wilkinson transferred a significant number of ordinary shares in P Ltd to their daughters. The daughters were also appointed non-executive (and unpaid) directors of a company that was a 100% subsidiary of P Ltd.

A deal was then carried out under which P Ltd was to be acquired by the BCA group through an acquisition vehicle, TF1 Ltd, for a consideration of £130million (the transaction).

On completion of the transaction:

- the shareholders (other than the daughters) received cash and loan notes;
- the daughters received a different class of loan notes and B ordinary shares in TF1 Ltd but no cash consideration.

These arrangements were designed so that s.135 TCGA 1992 applied so the daughters would:

- not suffer an immediate CGT charge on the gain arising from the sale of their shares in P Ltd;
- be eligible for entrepreneurs' relief when they redeemed their loan notes and sold their B shares a year later.

This had the effect of reducing the CGT rate payable by the daughters from 20% to 10%.

HMRC raised discovery assessments denying relief under s.135 TCGA on the basis that the exchange formed part of a scheme or arrangements of which the main purpose, or one of the main purposes, was the avoidance of a CGT liability by the Wilkinson family (s.137 TCGA 1992)

The couple appealed to the First Tier Tribunal.

Decision

The First Tier Tribunal considered two questions:

1. Was the exchange part of a scheme or arrangement?

It held that the only scheme or arrangement of which the exchange was a part was the deal to sell P Ltd to TF1 Ltd for a total consideration of £130million. It rejected HMRC's view that the exchange also formed part of another scheme or arrangement, namely the Wilkinsons' CGT planning. This was because, on a realistic view:

- (i) the CGT planning was not a self-standing scheme or arrangement in its own right, and

- (ii) even if the CGT planning could be said to be a self-standing arrangement, the exchange did not form part of it as the exchange was a much larger endeavour, involving more parties, than the CGT planning.
2. Was the avoidance of a liability to CGT a main purpose, or one of the main purposes of the transaction?

The First Tier Tribunal found that enabling the Wilkinsons' CGT planning was a purpose of the transaction but not a 'main purpose'. It was a purpose because the deal contained several features that would not otherwise have been present, such as granting the daughters B shares and directorships. It was not the main purpose, or one of the main purposes, of the transaction because the 'pre-eminent' main purpose was that of selling the company. The minority bloc of shareholders, who held 42% of P Ltd's shares, had no stake in the Wilkinsons' CGT planning. Even for the Wilkinsons, as the majority shareholders, viewed in isolation, the value of the CGT planning (circa £3m) was only 4% of their proceeds.

Olivia Wilkinson and others v HMRC (TC08887)

Adapted from the case summary in Tax Journal (8 September)

Septic tank part of the garden

Summary – A septic tank on part of the grounds serving a number of adjacent properties was part of living in the country and formed part of the garden and grounds of the property.

In September 2015, Andrew and Della Bloom bought a property for £4,400,000 comprising two registered titles:

- A house, cottage, swimming pool, garage, stables and equestrian facilities;
- 5,6 acres of land with a sewage treatment plant serving the property and ten neighbouring flats as well as a tennis court built by the taxpayers was at least partly on the land.

The only visible parts of the plant were manhole covers, and two small structures containing the electrical controls and for storage. The tennis court had been built close to the manhole covers.

Andrew and Della Bloom initially paid SDLT on the basis that the whole property was residential, but later claimed overpayment relief arguing that, due to the presence of the sewage treatment plant, it was in fact mixed-use.

HMRC disallowed the claim and the couple appealed.

Decision

The First Tier Tribunal found in HMRC's favour finding that the majority of the tennis court was sited on the land and stated:

“Given the 5.6 acres available in which this tennis court could have been erected it did not seem credible that it had been placed so near to a septic tank if it “constantly” emitted a repugnant smell.”

Further, the Tribunal found that:

- the septic tank was a mandatory requirement due to the lack of mains sewerage, not uncommon in the country;
- a well-managed and serviced septic tank should not 'constantly' emit smells and noted that this one was serviced four times a year.
- the agreement with the neighbours provided for the split of maintenance costs of the septic tank on a fair basis with no profits made. It represented a restrictive covenant and not a commercial agreement.

The appeal was dismissed.

Andrew Jonathan and Della Ann Bloom v HMRC (TC08866)

Marital home not main residence

Summary – Despite his separated wife and children continuing to live in the marital home, Additional Dwelling Supplement (ADS) was not refundable when he transferred that home to his wife, having bought a new home as it was more than 18 months between leaving the home and buying his new one.

In 2008, Alexander Duran bought a home in Edinburgh jointly with his now ex-wife.

On separation in 2015, he moved out permanently from the property and moved into temporary accommodation until in August 2019, he bought a new property and paid the ADS of £12,348 that fell due. He transferred his interest in the jointly owned property to his ex-wife and later submitted a claim for the repayment of the ADS previously paid.

Revenue Scotland denied the repayment as he had moved out of the marital home more than 18 months before buying the new property.

Alexander Duran appealed, arguing that although personal circumstances prevented him from living in the marital home, with no other permanent accommodation, it remained his main residence until purchase of the second in 2019.

Decision

The First Tier Tribunal for Scotland was sympathetic to his position but decided in Revenue Scotland's favour.

The Tribunal stated that it could only enforce powers given to it expressly by statute. This provided that to be eligible for a refund, the taxpayer must:

- within the period of 18 months beginning with the day after the effective date of the transaction (new property purchase), the buyer disposes of the ownership of a dwelling (the marital home); and
- the property disposed of was the buyer's only or main residence that he had occupied at some point during that 18-month period as his only or main residence.

Alexander Duran did not live in the marital home at any time in the 18-month period ending with the effective date of the transaction to buy his second property. The Tribunal stated that it was “difficult to envisage a scenario in which a property could be viewed as a main residence if, as a matter of fact, no time had been spent there in the relevant period”.

The appeal was dismissed.

Mr Alexander Joseph Duran v Revenue Scotland [2023] FTSTC 2