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## 1. Business tax

### Corporation tax small profits rates

- 1.1. Legislation will be introduced in Finance Bill 2011 to set the small profits rate (SPR) of corporation tax (CT) at 20% on and after 1.4.11.
- 1.2. The SPR for companies with profits, arising on and after 1.4.11, from oil extraction and oil rights in the UK and the UK Continental Shelf ('ring fence profits') will remain at 19%.

| Corporation tax on profits | April 2010-2011 | April 2011-12 |
|----------------------------|-----------------|---------------|
| £0 - £300,000              | 21%             | 20%*          |
| £300,001 - £1,500,000      | Marginal rate   | Marginal rate |
| £1,500,001 or more         | 28%             | 27%           |

\* The small profits rate was due to rise to 22 per cent in 2011-12, as announced originally at Budget 2007 and deferred to 2011-12 at 2009 Pre-Budget Report.

### Maximising the small companies rate

- 1.3. The lower small companies rate of corporation tax of 21% applies to profits of £300,000 or less. The full corporation tax rate does not apply until profits reach £1,500,000. Where there is more than one company under common control, these limits are divided by the total number of such companies which are carrying on a business (s13(3) ICTA 1988).
- 1.4. Where it can be commercially justified, the number of 'active' companies under common control should be reduced so as to maximise the availability of the lower rates of corporation tax. This can be achieved by transferring trades to existing companies, the acquiring company then carrying on two or more trades in divisions or simply merging the trades. Care should be taken where companies are not members of the same 75% group or a company has brought-forward trading losses, especially where the transferor is insolvent (see ss343, 344 TA 1988).
- 1.5. Where there is a small number of companies under common control, the benefit of the small companies rate can be obtained in one or more companies, whilst the remainder of the companies under common control make profits chargeable at the full rate, thus reducing the group's overall tax liability. This could be achieved by ensuring that the more profitable contracts (and capital gains in a group of companies) are routed through one company, by the careful use of commercially justifiable management charges and by allocating group relief in the appropriate manner. The marginal rate (currently 29.75%) on profits between the lower and upper limits (as reduced) are greater than the full rates (currently 21% and 38%) and are thus best avoided.

- 1.6. Where management charges are used in group tax planning, the question of VAT should not be overlooked.

**Associated companies: partners' shareholdings FA 2008**

- 1.7. The upper and lower maximum relevant amounts for small companies purposes are set out in s13(3) TA 1988. S13(3)(b) reduces the amounts if the company has one or more associated companies.
- 1.8. 'Associated company' is defined at s13(4) as one company controlling another or two companies being under common control, with s416 TA 1988 being used to determine control. In establishing control of a company, s416(6) requires the attribution to a person of any rights or powers held by his associates. S417(3) of ICTA defines the meaning of associate and s417(3)(a) includes business partner within that definition.
- 1.9. Legislation is introduced to revise the definition of 'control', solely for the purposes of SCR, by amending the wording of s13(2) TA 1988 and inserting new sub-ss4A, 4B and 4C into s13. This measure has effect on and after 1 April 2008.
- 1.10. The new wording and subsections ensures that the rights or powers held by business partners are attributed only when "relevant tax planning arrangements have at any time had effect in respect of the taxpayer company". "Relevant tax planning arrangements" are defined as arrangements which involve the shareholder or director and the partner and secure a tax advantage by virtue of greater relief under s13.

**Context**

- 1.11. At a recent meeting of the Corporate Tax Operational Consultative Committee, involving HMRC and professional bodies, representatives said while they accepted the need for rules to prevent profit fragmentation, the current definition of associates meant it was extremely difficult for taxpayers to know precisely with whom they were associated. Further, in many cases the rules meant that businesses with no economic connection were treated as being associated.
- 1.12. Subsequently, HMRC had the problem with those directors or shareholders who had invested in film partnerships, probably without realising that they were, at the very same time, potentially becoming associated with other investors (their partners and thus their associates under s416(3)(a)) in the same scheme. This came up again in the committee on 23.1.07, when it was noted that representatives raised some concern regarding the recent letters issued by Wick Office [requesting details from those involved in film partnerships]. HMRC agreed to have a separate meeting with the representatives to discuss this issue.

- 1.13. HMRC were asked what their plans were regarding other partnerships whose partners might be associated and wondered if certain types of partnerships (eg large firms of accountants) were being treated differently from others. The response was that HMRC are not applying different rules to the same categories of taxpayer. They are carrying out an exercise to identify taxpaying companies that are caught by the s416 legislation and will then apply the correct law to all of them.

**Associated companies: proposals**

- 1.14. A joint HMT/HMRC consultation document seeks views on a proposal for reforming the associated company rules as they apply to the small companies' rate of corporation tax. Following from FA 2008 changes affecting partners' holdings, the Government have continued discussions with representative bodies and tax advisers; these have identified that the main priority for further reform are the rules governing control of a company through the attribution to them of rights held by one or more of their associates. The proposal is that the attribution would only be made in cases where entities had been 'fragmented' as part of 'relevant tax planning arrangements'.
- 1.15. The proposed new test would not amend the status of companies within the same group or under the control of the same person or persons: these would still be automatically associated. It would only amend the circumstances in which rights held by linked persons are attributed between them to establish control. The test follows the approach taken by both the FA 2008 amendments and ESC C9 in seeking to ensure rights held are only attributed between linked persons where links between the companies are sufficient to consider them interdependent and thus fragments of a wider whole.
- 1.16. The guidance notes, published in draft with the proposal document, suggest that, whilst the rights of a person and his nominees will always be taken into account, the rights of others will only be relevant in limited circumstances, ie those of relevant tax planning arrangements. It suggests that there are three categories of links to consider: financial links, economic links and organisational links.
- 1.17. Signs of **financial** interdependence include:
- financial support given by one company, or its owner(s) to another company/companies. The company would not be viable without support from the other(s). The support may be directly to the company concerned or indirect in, for instance, the form of guarantees or cross-guarantees; and
  - a common financial interest in the affairs of a business shared by the separate companies.

- 1.18. Where more than one business activity is operated from the same or adjoining premises, and the existence of one guarantees or underpins the viability of the other, the companies should be considered to be associated.
- 1.19. Where there are direct and **economic** links between companies, it may be appropriate to treat them as associated. Indicators include:
- separate companies seeking to realise the same economic objective;
  - the activities of one company benefiting the other company/companies; and
  - separate companies supplying the same circle of customers.
- 1.20. Where there are direct and immediate **organisational** links between separate companies, such that they could not reasonably be run by a third party at arm's length from the other(s), they may be parts of a single enterprise. Inspectors are instructed to look for:
- common management;
  - common employees;
  - common premises; and
  - common equipment.
- 1.21. In determining 'control' for the purposes of s13(4) TA 1988, the attribution of rights held by associates is not intended to apply where there is an 'accident of circumstance' but rather on whether there has been in a real sense a 'fragmentation' of business activities. Each case will depend on its specific circumstances but there is no fragmentation of control in situations where:
- separate companies are controlled by associated persons but have no financial, organisational or economic links; and
  - the associated persons have not, and never have had, involvement in the affairs of the companies controlled by the other associated persons.

**Comment**

- 1.22. Iain Robertson suggests that, while HMRC await responses to their proposals, taxpayers with associated companies might review matters to see if they stand to win.

1.23. For instance, a husband and wife have separate businesses with profits expected of £250,000 each in the year to 31.3.10 and a cash surplus in each of £100,000 or more. A £100,000 bonus paid by the year end could lead to a double benefit:

- tax relief at 28% rather than 21%;
- income tax at a top rate of 40% rather than 50%.

1.24. Other companies which are likely to benefit from the rule changes should review the extent to which profit recognition can be legitimately deferred until the new rules come in. Were they to do so, or in certain cases adapt business practice to improve the position, the question could arise whether such tactics may themselves represent arrangements securing a tax advantage, creating issues within the new s13(4)(A) to (C) and so prevent the hoped-for benefits.

*(HM Treasury press release 29.10.09; Iain Robertson writing in Taxation 25.11.09)*

#### **Settlement provisions: husband and wife company**

##### ***The issue***

1.25. Whether dividends received by a shareholder should be taxed on her husband as income arising under a settlement.

##### ***The facts***

1.26. Mr and Mrs P agreed to purchase 85% of the shares in CD Ltd, an engineering company in which P was already employed and owned the other 15%. 2% of the shares were subsequently held by Mrs P and 98% by her husband. Two-thirds of the sale consideration was left on loan by the vendors and the immediate tranche funded by mortgaging the matrimonial home, owned jointly. A B class of shares was created and ten shares allocated to Mrs P.

1.27. Dividends paid on the B shares were transferred by Mrs P to her husband to be used to clear the debt to the vendors. It was claimed by the advisor to Mr and Mrs P that the structure established allowed Mrs P to avoid personal liability for the vendor loans; she was seen as akin to an outside investor, with a separate class of shares and priority dividends. Her return on the amount she had invested (half of the purchase price) was in line, he claimed, with the return an outside investor would have expected. The entire strategy was pre-ordained, except that Mrs P decided independently to pay the dividends to her husband rather than paying off the mortgage: the vendor loans had due dates and were therefore to be prioritised.

1.28. HMRC pointed to the tax saving in the arrangements and observed that there was no need for a separate class of shares. The B shares did not have any special right to

dividends. They argued that either the B shares themselves were settled property or that each dividend on those shares which was not matched *pari passu* on the A shares was effectively settled by P.

### ***The decision (FTT)***

- 1.29.** The company would not have paid the dividends on the B shares had not Mrs P agreed to pay them on to her husband. There was an 'arrangement' within s660G TA 1988; the Special Commissioner case of *Bird* [2008] SpC 720 emphasised that 'a relatively simple plan' could be included in the definition. To count as a settlement, there must be an element of bounty; this was missing in the present scheme. Although Mrs P was not in the position of an outside investor, the fact that she bore equal responsibility for the loans whilst holding far less than 50% of the capital meant that a constructive trust in her favour had been created; there was therefore no bounty extended to her. HMRC had not taken 'a broad and realistic view' of the arrangements (as Lord Hoffman in *Jones v Garnett* [2007] UKHL 35 had required). The outright gift exemption could not apply (since the dividend income was going to be applied for P's benefit in all foreseeable circumstances), but this was immaterial since the B shares were not settled.
- 1.30.** Could the dividends qualify as settled property instead of the shares? The decision to pay dividends on one class of shares could count as an arrangement (as with the waivers in *Buck* [2009] STC 6). But P effectively held 40.5% of the A shares in trust for Mrs P; hence the element of settlement was only to the extent that the dividends she was paid exceeded her entitlement as the beneficial owner of 42.5% of the A shares.
- 1.31.** The tribunal left the parties to agree the tax calculation for each year, but invited HMRC to consider equitable liability before pursuing assessments for earlier years, given that for the last year under consideration P had over-paid tax.  
(*Patmore v HMRC TC 00619 14.7.10*)

### **Claiming annual investment allowance**

- 1.32.** The increase in the annual investment allowance to £100,000 has effect for expenditure incurred on or after 1.4.10 for businesses within the charge to corporation tax and on or after 6.4.10 for businesses within the charge to income tax.
- 1.33.** In the Emergency Budget on 22.6.10, the new Chancellor announced that the AIA will be reduced to £25,000 from April 2012.
- 1.34.** Obviously, HMRC must amend their software to deal with these changes, as will other software suppliers.

- 1.35. HMRC have announced that they will implement the increase to £100,000 from October 2010 when its next big software release takes place. Until then, if an accounting period ends on or after 1.4.10 and a claim is to be made for the annual investment allowance, HMRC's online services will not be suitable to deliver a return or download the HMRC filing software.
- 1.36. If the return does not include a claim for AIA, the form can be downloaded and filed as usual.  
(Anita Monteith writing in TAXline September 2010)

### Tax Club posting

- 1.37. "If say we had an accounting year end 31 July 2010, the maximum AIA available would be £66,028, and the period prior to April 2010 is subject to a maximum limit of £50,000 with FYA available.  
So lets assume £56,000 was spent on qualifying plant and machinery prior to April and £25,000 post April. How is the AIA allocated?

Option 1 – Allocate the first £50,000 AIA to the period post April

Pre April expenditure - (£50,000 @ 100%) + (£6,000 @ 40%) = £52,400

Post April expenditure – (£16,028 @ 100%) + (£8,972 @ 20%) = £17,823

TOTAL ALLOWANCES = £70,223

Option 2 – Allocate the AIA to the latter period first, and the remaining AIA to the period pre April thus maximising FYA on the excess expenditure over AIA limit?

Post April expenditure – (£25,000 @ 100%) = £25,000

Pre April expenditure – (£41,028 @ 100%) + (£14,972 @ 40%) = £47,017

TOTAL ALLOWANCES = £72,017

You will note that the extra allowances arises due to the fact the expenditure in excess of AIA received FYA rather than standard WDA."

### Tax Club response

- 1.38. "AIA is only due if a claim is made and the taxpayer has the option of claiming less than the maximum AIA (CAA 2001 s51A(7)). I think it must follow from that that there is a choice and the taxpayer could choose Option 2 if that is more beneficial to him."

### IR35 and small businesses

- 1.39. The Government remain committed to a review of IR35 and small business tax and will release further details shortly.

**Loan used wholly and exclusively in a close company business*****The issue***

- 1.40. Whether a loan to a close company was used wholly and exclusively for the purpose of the business of the company.

***The facts***

- 1.41. T was director and chairman of W Ltd, a wholly owned subsidiary of O Ltd. O Ltd was owned 50% by T and 50% by M.
- 1.42. T obtained a personal loan of 3m Canadian dollars from A Ltd repayable with interest at a rate of 12% per annum. T loaned W Ltd the whole amount on identical terms with an identical rate of interest.
- 1.43. The purpose of the loan was to finance the development of hangar and maintenance facilities at the Lake Simcoe Regional Airport, Ontario, Canada through a Canadian company called WA Inc, a company registered in Canada and wholly owned by U Inc (also registered in Canada) and which in turn is a wholly owned subsidiary of WG in which T owned 50% of the shares and M owned 50%. W Ltd loaned C\$3m to WA Inc repayable at an annual rate of interest of 15%.
- 1.44. T claimed relief for interest of £143,000 paid to A Ltd.
- 1.45. HMRC disallowed the loan interest relief claimed and T appealed, arguing the loan interest was to a close company and qualified under s360 TA 1988. HMRC accepted that W Ltd was a close company but argued that the loan was not used wholly and exclusively for the purposes of the business of the company.

***The decision (FTT)***

- 1.46. The evidence from T was that although the main business activity carried on by W Ltd was the design, supply and installation of building envelopes, the company nevertheless undertook a number of other commercial projects in order to strengthen the company both operationally and financially; indeed the loan made was entered into for such purposes. The fact that interest was charged at a rate which gave W Ltd a 3% margin over the amount of interest that it was being charged by T, together with the facility and lending fees charged, corroborated the commercial interests of the company as stated. Further, the oral evidence of substantial fees from the design projects undertaken by W Ltd for WA Inc was indicative of a genuine commercial transaction. The points raised by HMRC as to the pre-determined use of the loan, similarity in loan agreements and their odd structure were considered carefully, but the tribunal took the view that, whilst

unusually structured, there was no evidence that would lead them to conclude that these were anything other than genuine commercial loans.

- 1.47. The appeal was therefore allowed.  
(*JS Torkington v HMRC TC00706 17.9.10*)

### **Accidental sales revenue**

#### ***The issue***

- 1.48. Whether sums of money mistakenly paid by customers and not repaid were liable to corporation tax under s18(3) TA 1988.

#### ***The facts***

- 1.49. P Ltd was a recruitment agency providing either temporary or permanent workers to its customers. It received payments which could not be matched with invoices or ongoing projects (in spite of the company going to considerable lengths to unite the payment with the payer) and would, each year, hold the money until the accounts were prepared, when the total thus accumulated would be transferred out of the balance sheet and into the profit and loss account. The amounts involved could reach nearly £500,000 pa.
- 1.50. Each of the overpayments was made by a customer under a mistaken belief that it owed money to P for services the company had supplied to it. P argued that this did not make them trading receipts but rather receipts from people they traded with. They argued that there must be a legal nexus or 'entitlement' that links the money to the trade, ie there must be a mutuality in the contract.

#### ***The decision (FTT)***

- 1.51. The tribunal found that amounts paid by mistake to P by customers belong to the company unless and until the customer makes a successful claim in restitution against it, or such a claim is settled by agreement. It observed that the overpayments received by P arose because of their trading activities and were therefore receipts arising or accruing from its trade. The payments were made by customers in the mistaken belief that they owed money to P for services supplied to them in the course of trade. Even though P did not carry on any specific activity which might be said to earn or encourage the receipt of these mistaken payments, their receipt was an inevitable and unavoidable incident of the company's trade.
- 1.52. The tribunal dismissed the appeal.  
(*Pertemps Recruitment Partnership Ltd v HMRC TC00519 10.6.10*)

## Partnership income taxed as employment

### *The issue*

- 1.53. Whether a termination payment made to a partnership sub-postmaster in relation to the post office closures was taxable in the partnership or directly on the individual.

### *The facts*

- 1.54. A payment of £74,647 was made to U under the post office closure scheme. While he accepted this was taxable under employment tax law, he argued that the excess over £30,000 should be treated as a capital payment in the partnership he ran with his wife, which sold stationery, sweets and snacks. The effect, he argued, was that the capital payment, after taper relief and personal annual exemption, gave rise to a capital gain for neither of the partners.
- 1.55. U stated that it was not possible for the partnership to be the sub-postmaster so the appointment was in his name alone. However, the correct tax treatment was to regard the termination payment as being received by the partners in the partnership and not by him personally. HMRC had accepted for many years the inclusion of remuneration from the Post Office as partnership income in its partnership accounts and tax returns; there was no reason why the termination payment should be treated any differently.

### *The decision (FTT)*

- 1.56. The tribunal found that the termination payment was received by U in his capacity as a partner with his wife in the partnership. It was partnership property, to which he and his wife were entitled in equal shares. As such, for the purposes of s401 ITEPA 2003, the tribunal considered that U could only be regarded as having received one half of the payment. The other half should be regarded as having been received by his wife.
- 1.57. Nonetheless, both halves of the payment were received 'directly in consideration or in consequence of, or otherwise in connection with' the termination of the office of sub-postmaster and accordingly the part of the payment received by the wife must, since she was his spouse, be counted as U's own employment income under s403. The tribunal noted that 'it seems odd that a husband and wife partnership should be treated less favourably in this respect than a partnership comprising non-relations, but the wording of the section is clear'.
- 1.58. The appeal was therefore dismissed.  
(*Lakbir Singh Uppal v HMRC TC00516 10.6.10*)

**Interest on client monies*****The issue***

- 1.59. Whether interest earned by a firm on client account monies was taxable as trading or savings income.

***The facts***

- 1.60. A firm of solicitors received interest on short-term funds held in a clients' account. In its tax return, the firm treated this interest as trading income. Although the individual amounts were relatively modest and remained in the account for a short time, the volume of the work meant that the aggregate balance in the firm's clients' account at any one moment was a very large sum, and the interest earned on it correspondingly significant, compensating for a loss on the fees earned. HMRC issued an amendment on the basis that the interest had to be taxed as savings income. The firm appealed.

***The decision (FTT)***

- 1.61. The tribunal allowed the firm's appeal. Judge Bishopp held that the interest was earned in the course of the solicitors' trading and as an integral part of the trading activities. On the evidence, the interest was properly to be regarded as part of the solicitors' trading income, because it was understood between solicitor and client that the interest would form part of the total fee.

*(Barnetts v HMRC TC00575 2.8.10)*

**When is an electronic transfer 'paid'?*****The issue***

- 1.62. Whether the payment or receipt of an electronic bank transfer was the key date to avoid late payment surcharges.

***The facts***

- 1.63. A couple paid their respective income tax liabilities electronically on 27.2.09. Although late, they were confident that the payments were in time to avoid a surcharge. HMRC disagreed saying that, as it was not received until 2.3.09, each payment was late. The couple each appealed on the grounds that, if the key date of payment for a cheque was the day it was sent, the equivalent rule for an electronic transfer should be the date of initiation of payment.

***The decision (FTT)***

- 1.64. The tribunal found that the tax was received by HMRC on 2.3.09 and that the tax therefore remained unpaid on the day following the expiry of 28 days from 31.1.09.

- 1.65.** The tribunal found that the contrast with cheque payments did not assist Mrs W's case. Firstly, there was a difference between bank transfers and cheque payments: a cheque is payable on demand so receipt of it gives rise to a cause of action against the person who issued the cheque before the cheque is banked. Second, Mrs W chose not to send a cheque but to pay electronically.
- 1.66.** The tribunal rejected Mrs W's submission that the tax was paid at the time of initiation of the electronic payment. If payment were effected by initiation of an electronic transmission, that initiation would extinguish a potential cause of action against Mrs W for non-payment, even if the payment did not reach its intended destination. The appeal was accordingly dismissed.
- (Mrs Lyn West v HMRC TC00707 20.8.10)*

#### **VAT payments by cheque**

- 1.67.** From 1.4.10 all cheque payments sent by post will be treated as being received by HMRC on the date when cleared funds reach their bank account, not the date when they receive the cheque. Businesses must allow enough time for their payment to reach HMRC and to clear their bank account no later than the due date shown on their VAT return.
- 1.68.** To allow for possible postal delays (for which HMRC point out they are not responsible) businesses should allow at least three working days for a cheque payment to reach them and a further three days for the payment to clear their bank account.
- 1.69.** A business may be liable to a surcharge for late payment if a cheque payment does not clear by the due date shown on their VAT return.
- 1.70.** This change does not affect cheque payments made by Bank Giro. Payments by Bank Giro are treated as electronic which means that businesses will get up to an extra seven calendar days for the cleared payment to reach HMRC (unless they use the annual accounting scheme or are required to make payments on account).
- (HMRC Brief 14/10 17.3.10)*

#### **Change of standard rate**

- 1.71.** Legislation is introduced to increase the standard rate of VAT from 17.5% to 20%. The new rate will have effect for any supply made on or after 4.1.11 and any acquisition or importation taking place on or after that date. S3
- 1.72.** Zero-rated supplies, such as basic foodstuffs, children's clothing and books; exempt supplies, such as education and health; and supplies subject to VAT at the 5% reduced rate, such as domestic fuel and power, are not affected by this change.

- 1.73. Detailed guidance for businesses on implementing this change has been published on the HMRC website.
- 1.74. Changes to the Payment on Account regime thresholds will be made at a later date to maintain the *status quo* of the scheme.

#### **Anti-forestalling legislation**

- 1.75. Legislation is introduced to counter arrangements that purport to apply the 17.5% VAT rate to goods or services to be delivered or performed on or after 4.1.11. In certain circumstances a supplementary charge to VAT of 2.5% will be due on supplies of goods or services on which VAT of 17.5% has been declared. Sch 2
- 1.76. The legislation has been targeted on artificial arrangements and is unlikely to affect suppliers conducting their business as they normally do when no VAT rate increase is anticipated.
- 1.77. The legislation will have effect for transactions on and after 22.6.10.
- 1.78. The legislation applies to standard-rated goods and services. It prevents forestalling by introducing a supplementary charge to VAT on the supply of goods or services where the customer cannot recover all the VAT on the supply, and one or more of the following conditions are met:
- the supplier and customer are connected parties;
  - the value of the supply (and any related supplies made under the same scheme) exceeds £100,000. But this does not apply if the prepayment or issuing an advance VAT invoice is normal commercial practice;
  - the supplier or someone connected to the supplier funds a prepayment for the goods or services; or
  - an advance VAT invoice is issued where payment is not due in full within six months (except hire purchase invoices issued in accordance with normal commercial practice).
- 1.79. The supplementary charge to VAT is due on 4.1.11 and must be accounted for on the supplier's VAT return covering that date.
- 1.80. Similar provisions prevent the use of the grant of standard-rated rights or similar options as an avoidance mechanism. They cover cases where before the rate increase the

customer is granted the right to receive goods and services after the rate increase, either free or at a discount, and the customer cannot recover all the VAT on the right or option.

- 1.81.** The charge does not apply to prepaid or invoiced rentals of land, buildings or other assets, if the period concerned is a year or less, and the prepayment or the issuing of an advance invoice is normal commercial practice.
- 1.82.** Suppliers may adjust the amount payable under contracts with customers for any supplementary charges, unless the contracts say otherwise.
- 1.83.** Guidance for businesses has been published on the HMRC website.

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## 2. Employment tax and NIC

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### Meeting leaders: status

#### *The issue*

- 2.1. Whether Weight Watchers (WW) meeting leaders were employed or self-employed.

#### *The facts*

- 2.2. WW meetings are run by an individual referred to as a 'leader'. This person is often a successful former 'member' who enters into a contract with WW to run a number of local meetings. The agreement states that the leader will run the meetings along set WW principles, will follow the rules as to who can be admitted as a member, will set up meetings at times and venues as agreed by WW and will only sell official WW products during meetings.
- 2.3. WW issue strict guidelines to leaders explaining their individual obligations to register as self-employed and pay the correct amounts of tax and NIC. HMRC have challenged the status of the leaders arguing that the evidence points to them being employed. WW and some leaders have appealed.

#### *The decision (FTT)*

- 2.4. The tribunal reviewed the evidence and found that a large number of factors pointed to the leaders being under a contract of service with WW and therefore employed.
- 2.5. The factors included:
- WW could replace a leader if they did not feel the leader was representing WW correctly in a contract which existed between WW and the member, not between the leader and the member;
  - WW effectively decided on the timings and places of meetings;
  - the majority of guidance to help the leader hold successful meetings given by WW was 'mandatory rather than aspirational';
  - WW demanded certain things of the leader including maintaining their weight within their 'gold goal weight'; and
  - the monies collected in meetings were insured by WW and had to be paid over within 24 hours of being collected for them.

**Comment**

- 2.6. An appeal is expected in the near future by WW who face a £23m tax bill having lost the case.

*(Weight Watchers Ltd and others v HMRC TC00367 19.2.10)*

**Emolument or distribution or both?****The issues**

- 2.7. Whether sums paid to employees as bonuses were liable to income tax under Schedule E or as distributions under Schedule F; whether the payments were subject to NIC.

**The facts**

- 2.8. PA (an international group company with headquarters in the UK and subsidiaries or branches in over twenty countries) had a clear and well-publicised philosophy about paying its employees/shareholders: the optimal approach to employee pay was to pay staff median salaries and then to award them generous bonuses from profits by individualised annual awards. PA accepted a bespoke proposal from a firm of accountants to re-route bonuses awarded to employees so that they were paid as dividends via shares in an unconnected company owned through an employee trust with independent trustees. Payments were received by employees in the tax years 2000-01, 2001-02 and 2002-03 for the accounting years 1999, 2000 and 2001 respectively. HMRC did not accept that the arrangements were effective to turn the sums into a form that prevented them being payments within the scope of PAYE or NIC. The number of shares allocated to each employee was based on a calculation performed by PA and the aim of the scheme was to motivate and encourage employees in the performance of their duties.
- 2.9. HMRC took the view that there was a common intention and understanding behind all the steps involved. Individuals who received awards under the Restricted Share Plan received them because of their employment by PA and not because of the Restricted Share Plan or other parts of the arrangements.
- 2.10. The tribunal judges considered that it did not follow that PA's view (that the payments were distributions) and HMRC's view (that the receipts were emoluments or earnings) were, as a matter of principle, mutually exclusive. One was looking at payments while the other was looking at receipts. The tribunal found that the payments were definitely emoluments, but they also accepted that any payment resulting from a share had to be taxed as a distribution. As a matter of income tax law, they could be taxed only as one of those two kinds of payment. Which was to prevail? In their view, the answer to that is unambiguously laid down by s20(2) TA 1988: the payments could only be distributions.

- 2.11. The tribunal was not prevented by any similar fundamental rule of NI law from reaching the conclusion that the payments received by the employees were earnings in spite of being distributions for income tax purposes. Hence the decision of HMRC under s8 Transfer of Functions Act was upheld. Both parties appealed, the company arguing that a payment could not be both a dividend and an emolument at the same time and so NIC could not be chargeable.

***The decision (UT)***

- 2.12. The Upper Tribunal could find no guidance or legislation that prevented an amount being both and, accordingly, the NIC charge would stand.  
(*PA Holdings Ltd v HMRC (and related appeal)* UT 7.7.10)

**Tax deductible clothing**

***The issue***

- 2.13. Whether a TV presenter could claim tax relief for the cost of clothing she wore only whilst on TV.

***The facts***

- 2.14. The appellant, W, is employed by the BBC as a television newsreader. In her 2004-05 tax return, she claimed certain deductions from her earnings, including:

|                                   |        |
|-----------------------------------|--------|
| Professional hairdo and colouring | £975   |
| Professional clothing for studio  | £3,231 |
| Laundry of professional clothes   | £325   |

- 2.15. W argued that these were allowable expenses under s336 ITEPA 2003 because there was no duality of purpose - she didn't wear any of the clothes when not appearing on TV - and that the only legislative difference between her claims and successful claims made by her self-employed colleagues was the difference between 'wholly and exclusively' and 'wholly, exclusively and necessarily'.
- 2.16. She argued that the clothing costs were necessarily incurred because, while she was prepared to present without clothing, her employers would not accept this and her contract implied that she should not be seen wearing the same clothes more than two or three times a month.

***The decision (FTT)***

- 2.17. The evidence did not suggest that W had her hair done and coloured immediately before performing her duties as newsreader and then changed it back again immediately afterwards. Therefore the costs could not relate wholly, exclusively and necessarily to the employment.

- 2.18. No express term in W's contract insisted she change her clothing as often as she said it implied but, even if it had, the requirement of a varied wardrobe would be an aspect of the requirement that clothing be of a standard required for the occupation.
- 2.19. W's lack of need of clothes for warmth (as it is warm inside the studios) and her readiness to read the news without clothes were not accepted as realistic by the tribunal, which rejected the argument that she only wears the clothes because her employer requires it. The tribunal therefore rejected W's appeal.  
(*S Williams v HMRC TC00397 8.2.10*)

### **Travel and subsistence claims**

#### ***The issue***

- 2.20. Whether travel and subsistence costs were incurred wholly, exclusively and necessarily in the performance of a doctor's duties.

#### ***The facts***

- 2.21. R was engaged as a locum consultant at Eastbourne General District Hospital during the period 2003 to 2004. The engagement was made through a recruitment agency. He incurred expenses in two areas: mileage and accommodation. The latter included rental on a flat, council tax and a deposit. The accommodation claim was brought about due to the fact that the accommodation provided by the hospital at no cost was felt by R to lack 'a decent level of hygiene'. As a result he sought alternative accommodation. He moved into private accommodation in Eastbourne not far from the hospital.
- 2.22. Mileage was claimed for travel between his home in Wolverhampton and the hospital. R claimed that this travel was to and from a temporary workplace within the meaning of s339 ITEPA 2003.
- 2.23. HMRC refused both deductions and R appealed.

#### ***The decision (FTT)***

- 2.24. The tribunal did not accept R's argument regarding a temporary workplace because that rule only applies if the individual is engaged to have a permanent workplace and is seconded to a temporary place. In this case, R was employed on a number of short term contracts at the same hospital, making the Eastbourne hospital his permanent work place.
- 2.25. The tribunal went on to find that, having been provided with free accommodation, R had made his own decision to rent a private flat; although the tribunal made no findings as to the conditions of the premises provided, they did not feel that this had any bearing on whether R was entitled to seek relief.

- 2.26. The appeal was denied.  
(*Dr Wolfgang Reiter v HMRC TC00587 3.8.10*)

**Training costs: off-the-job**

***The issue***

- 2.27. Whether the cost of training courses attended by an employee was an amount expended wholly, exclusively and necessarily in the performance of her duties.

***The facts***

- 2.28. B was employed as a specialist registrar by two NHS trusts. Throughout her period of employment, the terms and conditions of her employment included a training clause which required her to continue to hold a national training number and to attend meetings, courses and conferences 'in carrying out the duties of her employment' as prescribed by her managers. The courses and training that B attended were compulsory and a prerequisite of her maintaining her post and employment. B claimed deductions under s198 TA 1988 [s336 ITEPA 2003] for the costs of her courses.
- 2.29. The amounts were disallowed by HMRC who argued that, to fall within s198, the expense had to be related to an objective necessity imposed by the duties of the employment itself, irrespective of what the employer might prescribe. Further, the expenditure had to have been incurred in the actual performance of the duties of the employment as opposed to courses outside the time B was working. The General Commissioners said that the training had been sufficiently related to the employment to be deductible.
- 2.30. The High Court (Mr Justice Henderson) ruled that the General Commissioners had been fully entitled to take the view that attendance at the courses was an objectively necessary requirement of B's employment. It had not merely been a contractual obligation undertaken by her at her employer's request, nor had it been an extra-curricular obligation that she had chosen to undertake in order to qualify herself to do her job or improve her prospects of promotion. To assert that the commissioners had erred in law in taking the view that they had would amount to saying that it was impossible for the test in s198 to be satisfied in any case where the taxpayer was paid to undergo training. Stringent though the section undoubtedly was, there was no reason why it should be construed in such an extreme way.

***The decision (CA)***

- 2.31. By a majority verdict, the Court of Appeal dismissed HMRC's appeal. The interpretation of the findings made by the General Commissioners was properly open to the judge. There was no reason in principle why Dr Banerjee's successive contracts during the five-

year training period cannot and should not be characterised as 'training' contracts by which she was employed – and paid - to undergo both practical and theoretical exercises whose ultimate aim was the generation of a supply of qualified dermatology consultants for the benefit of the National Health Service.

**2.32.** Their lordships differed on the interpretation of the 'exclusively' principle. The leading judgment found that the potential for future professional advancement that Dr Banerjee derived from the courses was at most a secondary, or incidental, benefit of her expenditure. The dissenter found that an exclusive purpose had no room for primary and secondary elements, the latter being relegated to the point of extinction without a factual basis.

**2.33.** HMRC's appeal was dismissed.

*(HMRC v Banerjee CA 28.7.10)*

#### **Payments to employee for use of car**

##### ***The issue***

**2.34.** Whether amounts paid to employees constituted earnings.

##### ***The facts***

**2.35.** A company provided the services of apprentices and trainees to employers and supervised their training. It employed about 160 training advisors, who had to visit the trainees at their places of work. It paid these advisors a mileage allowance of 12/13p per mile, plus an annual payment which was described as a 'lump sum' but was actually paid in twelve monthly instalments. Initially the company accounted for NIC on these payments. Subsequently it submitted a repayment claim on the basis that the total paid per year was qualifying mileage payments up to a limit calculated at 40p per mile. HMRC rejected the claim on the basis that the payments were in any case 'earnings' on which contributions were payable.

##### ***The decision (FTT)***

**2.36.** The tribunal allowed the company's appeal, holding on the evidence that the payments were paid as motoring expenditure; they were not additions to salary and were not paid as earnings.

*(Total People Ltd v HMRC TC00661 2.9.10)*

#### **Excessive company car**

##### ***The issue***

**2.37.** In what capacity had an individual received a car from a company and accordingly what national insurance was due.

**The facts**

- 2.38. B Limited (the company) was a small plumbing business with B as sole director and Mrs B the company secretary. They were the only employees of the company.
- 2.39. The company provided Mrs B with a BMW 330D for business and private use. The purchase price of the car was approximately £32,000 and its annual running costs were about £6,000.
- 2.40. Mrs B, who did not receive any salary from the company, provided support for her husband in all aspects of the company's business including clerical and managerial. She did not have regular hours and was called upon to work nights and weekends, responsible for all administrative functions. She used the car as a necessity, for example taking deliveries of equipment and transporting it to wherever needed by B. Mrs Barnard worked part-time elsewhere for three mornings each week and cared for the couple's two children.
- 2.41. HMRC accepted that Mrs B had the benefit of the car in her own right as an employee but argued (under s169(4) ITEPA 2003) that the making available of an equivalent car was not in accordance with normal commercial practice for an employment of the kind held by Mrs B; the car was provided as a result of her marriage.
- 2.42. B argued that the decision to buy the car was a commercial decision based on Mrs B's employment, not her relationship to the director. He referred to the duties performed by Mrs B contending that the provision of the car was not 'abnormal commercial practice' and was 'quite common for an employment of that kind'.

**The decision (FTT)**

- 2.43. The tribunal accepted the HMRC position that the legislation was not concerned with whether the value of the overall remuneration package was commercial but whether the provision of an equivalent car was normal commercial practice in relation to a job of the kind that Mrs B held. There was insufficient evidence (partly due to the need not to breach client confidentiality) to show that HMRC were wrong in their assessment and so their verdict stood and the appeal was dismissed.
- 2.44. As well as the additional NIC due, a penalty of 100% of the unpaid NIC was also due. (*S Barnard Ltd v HMRC TC00491 19.5.10*)

**Less tax, same NIC**

- 2.45. A recent tribunal case (*S Barnard Ltd v HMRC*) concerned a BMW car provided to a company secretary, wife of the controlling director. The company contended, unsuccessfully, that this was normal commercial practice and the benefit in kind should

be taxed and charged to NIC directly on the wife, rather than on the husband (as provision to a family member).

- 2.46.** The car benefit (and fuel benefit), together with any small salary, may have fallen below £8,500 and thus if taxed on the wife would not be taxed at all (as a low-earning non-director). The legislation is designed to catch just this sort of situation.
- 2.47.** Note, however, that in other circumstances if the planning aim were simply to pay a lower rate of income tax (assuming the wife's marginal rate to be less than the husband's) the solution would be to make the wife a director so that the benefit would be taxed on her in her own right and not on someone else as a family member. The overall Class 1A paid by the company would be the same either way but the tax saving could be almost £5,000.

*(Peter Arrowsmith writing in NIC Newsletter 1.10.10)*

#### **Employee's mobile phone: when is it tax-free?**

- 2.48.** The answer, according to HMRC, is when it is a Personal Digital Assistant (PDA) such as a Blackberry or device with similar functionality. This could be an important distinction when employers complete P11Ds, although in practice most employees should still not be taxed on their employer-provided PDA.
- 2.49.** Since 6.4.06, for new mobiles provided to an employee, the definition of 'mobile telephone' in s319 ITEPA 2003 has been 'apparatus designed for the primary purpose of transmitting and receiving spoken messages'. As PDAs also include computer functions they are not considered to be a mobile phone for these purposes. The exemption from tax under s319 ITEPA 2003 for a single mobile provided to an employee does not therefore extend to PDAs, which are taxed in the same way as computers.
- 2.50.** However, provided that the PDA is solely for business use and any private use is 'not significant', the provision of the PDA will be exempt under s316 ITEPA 2003. 'Not significant' is not defined in legislation but guidance is given in the employment income manual at EIM21613.
- 2.51.** In the more unusual situation where an employee is provided with two handsets, employers need to take care that P11Ds are completed correctly. If one handset is used solely for business (or private use is insignificant) and the other has both business and private use (or wholly private use), the distinction between PDA and standard mobile will be important.

- 2.52.** If both handsets are mobiles, there should be no tax charge. This is because the handset used mainly for private purposes can be exempt under s319 ITEPA 2003 and the other, being for business use only, is exempt under s316 ITEPA 2003.
- 2.53.** However, if two PDAs are provided, the s319 ITEPA 2003 exemption does not apply so only the PDA used solely for business will be tax-free and the cost to the employer (including rental, call charges, insurance, VAT etc) of the provision of the PDA which has private use will be taxable and should be included on the P11D.  
*(Angela Williams writing in TAXline May 2010)*

#### **Cycle to work**

- 2.54.** After consultation, HMRC have now updated the employment income manual to include details of a simplified approach to valuing cycles when sold to an employee after the end of a loan or salary sacrifice period as a transferable asset.
- 2.55.** Currently, a bike can be sold to an employee at the end of this period for the fair market value and after one year the figure most commonly used is 5% of the original value of the cycle. HMRC's updated guidance says that this figure is too low for most one-year-old bikes. HMRC have produced an optional valuation table with the age of the cycle varying from one to six years plus and the original price of the cycle being either less or more than £500. There is then a range of acceptable disposal value percentages. For example, a cycle that is one year old with an original price of £350 could be sold to an employee for 18% of that figure. A cycle aged six years or over would have a negligible value so would be worth virtually nothing by this time.
- 2.56.** There has been, however, no change to the actual rules. As long as any payment that the employee makes for the cycle is equal to or more than the market value, there will be no tax charge under the employment income rules. If the employee pays less than market value, the difference will be taxable as employment income.  
*(Diana Bruce writing on AccountingWeb 25.8.10)*

#### **Changes to employer-supported childcare**

- 2.57.** With effect from 6.4.11, the amount of exempt childcare that can be provided to a given employee will depend upon a 'basic earnings assessment' made by the employer at the beginning of the tax year. If the assessment shows that the employee is likely to be a higher rate or additional rate taxpayer, then the weekly limits will be £28 and £22 respectively. Basic rate taxpayers and those who already participate in an employer-supported childcare scheme before 6.4.11 will be subject to the familiar £55 per week limit.

- 2.58.** HMRC have published two sets of questions and answers, for employers and employees respectively, to highlight the changes of which each needs to be aware.

*(HMRC website 28.10.10)*

#### **Coding for 50% tax on multiple employments**

- 2.59.** The PAYE system does not provide a method for deducting a flat 50% tax from second or subsequent employments or pensions for those earning £150,000 or more. The D0 coding will only deduct 40%.

- 2.60.** HMRC have advised that, in the absence of an appropriate 50% tax code to apply to second or multiple employments, employees, directors or pensioners with multiple sources of income may find that their tax deductions are not accurate when their various incomes are combined and they become liable to tax at 50%. As a result, PAYE will not deduct enough tax in some cases.

- 2.61.** In these cases, HMRC will work out how much tax these individuals are actually due to pay when they send in their 2010-11 SA tax return.

*(David Reilly writing in TAXline September 2010)*

#### **NIC holiday for new business**

- 2.62.** One of the announcements from the new government was the planned introduction of a regional employer NIC holiday for new businesses. During a three-year qualifying period, new businesses starting up in certain areas of the UK will get a substantial reduction in their employer NIC. While no formal guidance has been issued, some information about the operation of the scheme is circulating.

- 2.63.** Employers will need to register with HMRC and then send an additional paper return by 19 May detailing how much of the NIC due they have not paid (ie deducted from payment) under the scheme. There will be no electronic versions of the NIC holiday annual return.

- 2.64.** No software changes are required as returns will not change and calculations will not change.

- 2.65.** Withholding NIC due can start from 6.9.10. Employers should calculate NIC as usual and all returns as though normal contributions are being taken. Agents/bureaus may need to think about BACS payment of statutory payments as a registered employer would want to reduce the value due. End of year returns will have a manual supplementary P35/NIC Holiday Return with standard P35 showing as though NIC were paid.

- 2.66. Other aspects are dealt with in the article.  
(*Diana Bruce writing on AccountingWeb 25.8.10*)

#### **Wasting NIC holidays on family members**

- 2.67. New businesses operating through a limited company and wishing to claim the new NIC holiday relief should beware appointing too many family members as directors unless they are going to be working full time in the new business and be fully remunerated.
- 2.68. Since all directors count as employees towards the first ten that qualify for the relief (even those - directors and others - paid below the earnings threshold), any new business expecting to take on close to ten arm's-length employees in their first year of trading will maximise the holiday relief by not appointing directors unnecessarily, purely for sentimental reasons or because of family pressures. By all means do so later, after the first year's trading is complete, and avoid making token payments in the meantime too.  
(*Peter Arrowsmith writing on TaxationWeb 6.9.10*)

#### **Pool car for one person?**

##### ***The issue***

- 2.69. Whether a company-owned car was a pool car or for the sole benefit of the controlling director.

##### ***The facts***

- 2.70. HMRC issued a ruling that a company which operated a restaurant was required to pay Class 1A NIC in respect of a Jaguar car which was owned by the company and used by its controlling director, Y, for delivering takeaway meals and transporting staff. The company appealed, contending that the car should be treated as a pool car within s167 ITEPA 2003 because it was made available to a number of staff members.
- 2.71. The car was insured for use by Y and his wife for social and domestic purposes and for purposes in connection with their businesses or professions. No insurance was taken out for other persons to drive the car. Y lived about two miles from the restaurant. The car was kept overnight at his house. The restaurant was on a main road and did not have parking space.

##### ***The decision (FTT)***

- 2.72. The tribunal rejected the company's contention and dismissed the appeal, finding that there was no evidence that the car had actually been driven by any person other than Y; hence the condition of s167(3)(a) was not satisfied. Given the nature of the car it was

likely that there was some private use of it by Y and that it appeared that the car was frequently kept overnight at Y's home, so that s167(3)(d) was also not satisfied.

*(Yum Yum Ltd v HMRC TC00616 23.8.10)*

### **Self-employed: small earnings exception**

**2.73.** It was previously possible for an employed person with a small, separate self-employment not to pay class 2 NIC without the need for a small earnings exception application. This was provided the self-employed profits were £1,300 or less for the year in question.

**2.74.** As a result of the HMRC review following the *Wilkinson* case this easement has now ceased (HMRC national insurance manual NIM20011).

*(Peter Arrowsmith writing on Taxationweb June 2010)*

### **Class 3 paid in error?**

#### ***The issue***

**2.75.** Whether Class 3 NIC had been overpaid in respect of benefit entitlement rather than pension rights.

#### ***The facts***

**2.76.** F was made redundant in 2002. He was informed by HMRC that he had not made NI contributions for enough qualifying years to be entitled to a full basic state pension.

**2.77.** HMRC informed F that he could make voluntary Class 3 contributions to improve his future entitlements to the state pension and also to the bereavement allowance which he also claimed.

**2.78.** In May 2006, the qualifying period for men and women was equalised, becoming 30 years. F sought to claim a refund of the voluntary contributions he had made over the three-year period, namely, April 2003 - April 2006, on the ground that they had been paid in error. HMRC rejected that claim and the respondent appealed.

**2.79.** The General Commissioners rejected the appeal so far as it related to the contributions having been paid in error but upheld it on the grounds that HMRC could not show that the contributions had increased the respondent's entitlement to bereavement allowance. That finding was based on the terms of a letter from HMRC to the respondent, which stated that the contributions did not fall to be refunded because 'they [could] still be taken into account for certain benefits'. HMRC appealed.

#### ***The decision (ChD)***

**2.80.** The appeal would be allowed.

**2.81.** Under the relevant legislative provisions, the only circumstances in which refunds could be given were either where contributions had been made in error or where precluded contributions had been made. No other basis to entitlement to a refund existed.

*(HMRC v Fenton ChD 17.6.10, ex tempore judgment reported by LexisNexis)*

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### 3. Personal tax

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#### **Pensions: reduction of the annual allowance**

- 3.1. The Treasury have published draft legislation, together with a draft explanatory note, for the reduction of the pension annual allowance. From April 2011, the annual allowance for tax relief on pension savings for individuals will be reduced from the current level of £255,000 to £50,000 with (more significantly) the lifetime allowance falling from £1.8m to £1.5m.
- 3.2. An annual allowance of £50,000 will affect 100,000 pension savers of whom 80% will have incomes over £100,000.
- 3.3. To protect individuals who exceed the annual allowance due to one-off spikes in accrual, the Government will allow individuals to offset this against unused allowance from previous years.
- 3.4. There is also to be consultation on options enabling people to meet tax charges out of their pensions.  
*(HM Treasury press release 14.10.10)*

#### **Crackdown on buy-to-let landlords**

- 3.5. Special tax evasion teams have added millions to the Treasury's coffers by trawling official records to check on buy-to-let landlords who have sold their properties.
- 3.6. The investigations by HMRC raised the amount of capital gains tax collected over the past year to £73.6 million, 23% up on the total for 2007-08 even though the recession has halved the overall liability for the tax.
- 3.7. Although the number of investigations fell 31% to 6,800 over the past year, the amount each yielded jumped, typically by 79% to £10,800.
- 3.8. According to UHY Hacker Young, an 'aggressive' HMRC team has been systematically going through Land Registry data to target property sales by buy-to-let landlords. Roy Maugham, tax partner at the firm, said: 'Gains on property transactions are a particular area of attention for HMRC. Other inquiries involve challenges to whether a property is really a taxpayer's main residence and, therefore, exempt from CGT.'  
*(Gary Parkinson writing in The Times 21.6.10)*

#### **Holiday homes face tax squeeze**

- 3.9. HMRC are consulting on their plans for new legislation to replace the current furnished holiday lettings regime, with consultation open until 22.10.10.

- 3.10.** The latest FHL proposals seek to tighten up the conditions under which the favourable tax regime can apply, and to modify the rules on loss relief as follows:
- A qualifying property must presently be available for letting to the public for 140 days a year. It is proposed that this be increased to 210 days a year, ie 30 weeks;
  - A qualifying property must actually be let to the public for 70 days a year; this will increase to 105 days or fifteen weeks; and
  - Losses made in a UK or EEA FHL business will be restricted so that they can only be set against profits from the same FHL business. This ends the favourable loss relief available on FHL activities.
- 3.11.** Other proposals formalise the treatment of capital allowances. Under the FHL rules, a property must meet the letting conditions in order to claim capital allowances in the year; strictly there should be a disposal of the assets on which allowances have been claimed when the letting period drops below the required level, as these assets no longer qualify for allowances. HMRC have taken a concessionary approach when a property fails to qualify for what is anticipated to be a temporary period, but this approach needs formalising.
- 3.12.** The new capital allowance rules propose that the plant which qualifies under the FHL regime, but not under normal letting rules, is maintained in a separate pool or pools. No allowances will be granted in periods for which the property does not qualify, but additions to and disposals from the pool will be dealt with in the period, the written down value being brought on stream again when the property once again qualifies.

*(HM Treasury website 27.7.10)*

#### **Holiday letting: a trade in any case?**

- 3.13.** The Labour government's abortive abolition of the furnished holiday letting regime calls for a greater appreciation of the tax rules on the distinction between trading and income from land and property. [The Emergency Budget announced that the regime would continue, with some changes yet to be consulted on; even so,] it seems that in many cases where it applies, a trade may in fact be being carried on in accordance with case law.
- 3.14.** There are three cases that are worth considering further and the first (*Coman v Rotunda Hospital* [1921] 7 TC 517) related to a charitable maternity hospital in Dublin and the letting of the Rotunda Rooms prior to the First World War. While the Special Commissioners found that the activity amounted to a trade, the High Court and the Court

of Appeal both held that the income was that from land and property. However, the House of Lords held that it was income from trading, given that the hospital:

- retained control of the premises, selecting the persons to whom the use was granted;
- properly fitted up the rooms; and
- provided attendance and other services.

**3.15.** If another person is being allowed unfettered use of the property, a trading conclusion is not available within this judgment.

**3.16.** A decade later, *Salisbury House Estate Ltd v Fry* (1930) 15 TC 266 involved the owner of a large office block let to tenants as unfurnished offices. The property consisted of 800 unfurnished rooms let out to some 200 tenants with 78 leases for periods ranging from 2 to 21 years together with 89 tenancy agreements and 26 informal tenancies. But while the scale was large, it was still only letting income. The company gave clear property rights to the tenants for their individual offices and the services were no more than one would expect from a landlord being manager of the common areas.

**3.17.** *Griffiths v Jackson* [1983] STC184 was a significant case in the period of uncertainty prior to the introduction of special rules for furnished holiday letting. It concerned the letting of furnished accommodation, mainly to students. Provision of other services was limited to some laundry services, arrangements for cleaning of rooms and gardening. The High Court held that it amounted to land and property income. The *Rotunda Hospital* case had been distinguished from *Salisbury House* in that in the former 'the taxpayers remained in legal occupation of the entertainment rooms and retained control over them'.

**3.18.** The relevance to furnished holiday lets is that, where the owner of the property is in occupation of the whole of the premises, a relatively modest amount of other services will be sufficient to constitute the carrying on of a trade. The services simply need to be above the level of that of a mere landlord (as will be found in most hotels).

**3.19.** It is very common to have complexes of several holiday letting units together with owners' accommodation. There may be a laundry room, swimming pool, children's play area and some other facilities. Typically these properties are converted farm buildings and comprise one integral unit. In such cases and on the basis of the established case law, it would therefore seem that the activities amount to a trade rather than being taxed under furnished holiday letting rules. The benefit for capital gains tax will be partially offset by the national insurance implications.

- 3.20. Businesses affected by these considerations need to reconsider the basis on which they are self assessing their activities for tax purposes; it is hoped that some further guidance might be forthcoming from HMRC.

*(John Endacott in Taxation 10.6.10)*

### **Gift aid relief**

#### ***The issue***

- 3.21. Whether a taxpayer could claim gift aid carry back relief, having amended his tax return for the year.

#### ***The facts***

- 3.22. A farmer, C, submitted his 2005-06 tax return in August 2006. In November 2006 he set up a charitable trust, and in January 2007 he made a substantial payment to the trustees. Later that month he submitted an amended 2005-06 tax return, claiming to carry back gift aid relief in respect of this payment against his income and gains for 2005-06. HMRC rejected the claim on the basis that the legislation specifically provided that such a claim could only be made in C's original return and could not be made in an amended return. C appealed.

#### ***The decision (FTT)***

- 3.23. The tribunal dismissed the appeal observing that while 'common sense and fairness appear to be on the taxpayer's side' the wording of the legislation was clear and unambiguous. The requirement that an election may not be made in an amendment to a return might encourage delay in the delivery of returns, but this was 'not absurdity in the sense of a result wholly inconsistent with the aim of encouraging charitable giving. It is in the circumstances an odd stipulation and one for which no clear policy may be evident, but that is not the same as absurdity or repugnance.'

*(J Cameron v HMRC TC00415 26.3.10)*

### **Gift Aid: effect of deed of variation**

#### ***The issues***

- 3.24. Whether a deed of variation represented a benefit to the individuals making it, in their capacity either as personal representatives or as beneficiaries; accordingly, whether Gift Aid relief was available.

#### ***The facts***

- 3.25. A brother and sister benefited from an absolute half interest in the estate of their mother. Each executed a deed of variation, passing in total £550,000 to a charitable trust. They claimed income tax relief on the basis that the payments to the trust were qualifying donations for Gift Aid purposes.

- 3.26. HMRC noted that s25 FA 1990 required that neither the donor nor any person connected with him receive a benefit in consequence of making the gift; the IHT saving, however, represented such a benefit, either to the individuals as personal representatives on whom the IHT liability fell or to the same people as beneficiaries, receiving more from the estate as a consequence of making the deed of variation.

***The decision (FTT)***

- 3.27. The tribunal found that the statutory material was unambiguous, requiring no reference either to the parliamentary debate (following the principle in *Pepper v Hart* [1993] AC 593), and declined to be guided by the press releases issued by Inland Revenue at the time of the 1990 Budget.
- 3.28. The individuals had received no benefit in their capacity as personal representatives, since the tax is treated as part of the general expenses of an estate and an IHT liability could therefore not result in a loss to the personal representatives; it followed that a reduction in the IHT liability could not give rise to a benefit. HMRC suggested that the benefit had been received by a connected person, ie their mother as settlor. The tribunal concluded that the definition of settlor in s839 TA 1988 is a present tense definition excludes connection with deceased persons.
- 3.29. Whether there was a benefit for the individuals as beneficiaries depended not only on the identification of a benefit but also that it was received in consequence of making the gift. S142 IHTA treated the settlor as making the gift, but this statutory fiction did not apply to income tax. The deed of variation had been made by the individuals who benefited from the reduction in IHT. This benefit had been 'received' by them, in that there would have been a liability to IHT in the absence of the deed. Finally, the benefit had been received 'as a consequence of making the gift' even though the actual payments to the trust were made later than the deed.
- 3.30. The tribunal noted that they had come to the same decision as in *St Dunstan's v Major* [1997] STC (SCD) 212, even though expressed differently; both judgments emphasised that the making of the gift comprised not simply the payments to the charity but all the arrangements for making the gift, including the deed of variation.
- 3.31. The appeal was dismissed.  
(*Harris v HMRC TC00667 18.8.10*)

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## 4. Capital gains tax

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### UK resident or working abroad?

#### *The issue*

- 4.1. Whether an individual had been resident and ordinarily resident in a particular tax year or working full time in The Netherlands.

#### *The facts*

- 4.2. A company director, H, who was born in the UK, became the managing director of a UK company, B, in 1982. In 1985 he arranged a management buy-out and in 1987 he transferred his shares in B to family trusts resident outside the UK. In 1997 his family trusts sold their holdings in B to a venture capital fund and realised substantial capital gains but retained an interest in B. In February 1998 H began working for M, a Netherlands subsidiary of B, while continuing to be chairman of B. In March 1999 the capital gains which H's family trusts had realised in 1997 were crystallised. H submitted a 1998-99 tax return stating that he had not been resident or ordinarily resident in the UK, and that he had been working in The Netherlands during that year. In 2004-05 HMRC issued a discovery assessment, charging CGT of more than £30m on the basis that H had been resident and ordinarily resident in the UK in 1998-99. H appealed unsuccessfully to the First Tier Tribunal.
- 4.3. The tribunal found that during 1998-99 H had spent 130 days in The Netherlands and 82 days in the UK. He had also spent 113 days in Barbados, where he had travelled on holiday and had remained on medical grounds after being taken ill. They found that his move to The Netherlands was no more than occasional residence abroad. His work for M was not full-time and some of his visits to the UK had been for the purposes of his duties as B's chairman. Furthermore, the discovery assessment was valid since H's tax return had stated that he was employed abroad under a full-time working contract of employment and it was not until later that HMRC discovered that H had in fact spent less than half the year in The Netherlands. H's conduct in signing the return amounted to negligent conduct within s29(4) TMA 1970. H appealed, contending that the tribunal's findings of fact were not sufficient to support its conclusion.

#### *The decision (UT)*

- 4.4. The Upper Tribunal found that the First-tier Tribunal had come to the right conclusion for the right reasons: it had concluded that a discovery had been made. Those were findings of fact which were not susceptible to challenge on appeal.

*(Hankinson v HMRC UT 30.9.10)*

**Tax planning: selling business assets**

- 4.5. The changes to entrepreneurs' relief in the emergency budget will have focused the mind of many agents and business owners. Important areas to review on behalf of clients will be:
- 4.6. *Are there shareholders owning less than 5% of the issued share capital, and voting rights? If so, can their shareholding be increased to 5% for at least twelve months prior to a proposed sale? Ensure share capital includes voting rights.*
- 4.7. *Companies with share option schemes in place* There will commonly be a practice where employees exercise their share options and immediately sell the shares acquired. These disposals will not qualify for entrepreneurs' relief unless the employee has an underlying shareholding of at least 5%. There have been calls for this to be addressed since relief was available in this situation under the previous taper relief rules, but it appears that entrepreneurs' relief is intended to reward entrepreneurs for risk rather than employees. To address this, consider whether it is feasible for an underlying shareholding of at least 5% to be owned by the individual. If so, relief will apply to all disposals.
- 4.8. It is now more important to *ensure shareholders are either officers or employees of the company for the qualifying twelve month period*. Whilst it is arguable that someone acting as a shadow director is an 'officer' of the company, HMRC have no published guidance on this, therefore a formal appointment should be put in place.  
*(Lesley Stalker writing on AccountingWeb 4.8.10)*

**Don't overlook entrepreneurs' relief**

- 4.9. With entrepreneurs' relief now worth up to £900,000, many owners are starting to make plans for future sales of their businesses.
- 4.10. If someone is selling a business unexpectedly, and some of the shareholders are not directors, it might be worth considering taking part of the deal in loan notes. Sell 95% for non-qualifying corporate bond notes and hold 5% as shares under a put and call arrangement. The purchaser will probably be prepared to go ahead with the deal and the seller qualifies for entrepreneurs' relief once twelve months have passed. The loan notes also qualify for relief, so you can use the shares to qualify for the relief on the loan notes.
- 4.11. Consider setting up a non-trading subsidiary. Employee/directors of non-trading subsidiaries can still qualify for the relief, as long as they are part of a group that is trading. Many legal firms have already taken advantage of entrepreneurs' relief by restructuring their firms and selling portions to corporate partners.  
*(Report of Mike Warburton's presentation at Iris World on AccountingWeb 20.10.10)*

**Deferred gains and F(No 2)A 2010*****Gains deferred from before 23.6.10***

- 4.12.** Where a disposal after 22.6.10 triggers a pre-6.4.08 gain, deferred through the reorganisation or EIS provisions, or a similar deferral after 5.4.08 but before 23.6.10, the resultant tax charge may be much greater than was originally anticipated.
- 4.13.** The principal change is that entrepreneurs' relief is now a relief that charges capital gains at a newly-created 10% tax rate, instead of being a relief which reduced the amount of capital gain otherwise chargeable by four-ninths. Gains not attracting entrepreneurs' relief will be taxed at 28%, to the extent that the basic rate band has already been used.
- 4.14.** Suppose a gain was deferred from before 6.4.08 on an exchange of shares for QCBs. It is expected that there will be three occasions of redemption of the stock, in equal tranches. If the first redemption of the loan stock took place before 23.6.10, the 'appropriate proportion' of the total deferred gain is established at that time – allowing the entrepreneurs' relief that would have been available had it been in existence at the time of the original disposal. Subject to applying the lifetime cap, the capital gain will be reduced by four-ninths and the balance taxed in the normal way, ie at 18%. The entrepreneurs' relief is set at a level determined by this event for all subsequent redemptions.
- 4.15.** If the second loan note encashment also takes place in 2010-11 but after 22.6.10, then the 'appropriate proportion' of the remaining deferred gain will be taxed at 28% (if the income tax basic rate band has been utilised). This is a rate of 15.55%, a 55.55% increase when compared to the tax payable on the first encashment.
- 4.16.** Assuming that the 28% rate of capital gains tax is not increased before 1.5.11, the same rate of tax will arise on the final encashment (ignoring the annual exemption).
- 4.17.** Where the original deferral took place on or after 6.4.08 but before 23.6.10, the individual making the disposal had the opportunity of claiming entrepreneurs' relief (if the appropriate conditions are met) so as to reduce the gain deferred; the cash flow benefit would be achieved at the point the QCB was redeemed.
- 4.18.** Prior to 23.6.10, the effect was to charge five-ninths of the original gain at 18%, which gave the effective rate of 10% that the legislation was designed to achieve. If, however, this was only a partial disposal, any subsequent disposal on or after that date will be charged at an effective rate of 15.55% as above. Where the whole deferred gain falls into charge on or after 23 June, the new 10% rate will apply to the whole of that gain.

**Deferrals after 22.6.10**

- 4.19. The ability to reduce the gain deferred under a share-for-QCB exchange has been withdrawn for exchanges taking place on or after 23.6.10.
- 4.20. Instead, the taxpayer can either:
- elect to treat the exchange as a transaction giving rise to a taxable capital gain (ie disapply s116(10) TCGA 1992), thereby bringing the gain into charge to tax at the new 10% tax rate; or
  - defer the full gain without regard to entrepreneurs' relief. The 10% entrepreneurs' relief rate will only be applied if the entrepreneurs' relief conditions are satisfied when the deferred gain comes into charge. In many instances, the company issuing the loan notes will not be the taxpayer's personal company.
- 4.21. It is likely that in most cases the decision will be to elect to disapply s116(10) and pay tax on the gain attributable to the QCB consideration at 10%, despite the cash-flow downside.
- 4.22. The articles also consider the position for EIS deferral cases and for share-for-share exchanges.  
*(Kevin Slevin writing in Taxation magazine, 26.8.10 and 16.9.10)*

**Share loss relief**

- 4.23. HMRC have issued guidance explaining a change in their practice on relief against income for capital losses made on shares subscribed for in qualifying trading companies ('share loss relief'). The change of practice applies where individuals subscribe for a joint holding of shares or subscribe for shares through a nominee.
- 4.24. Individuals who subscribe for shares where enterprise investment scheme income tax relief is attributable to those shares or for shares in a qualifying trading company (as defined by s134 ITA 2007) and who make a loss on the disposal of those shares, can claim to set off that loss against income rather than against capital gains.
- 4.25. S250 ITA 2007 permits EIS income tax relief where the subscription was made by a nominee on behalf of the individual or on behalf of joint owners. In the latter case the income tax relief is divided equally between the joint owners.
- 4.26. Where EIS income tax relief was not attributable to the shares, there is no equivalent legislation to extend relief to subscriptions by nominees or joint owners. Previously,

HMRC took the view that share loss relief for such subscriptions was available only where an individual personally subscribed for shares as a sole subscriber. They did not consider that relief was available where the subscription was made in joint names, for example by a married couple. Nor did they accept relief where the subscription was by a nominee on behalf of a beneficial owner.

**4.27.** HMRC have reconsidered their practice and will now accept claims to relief for losses on the disposal of qualifying shares in such cases. The proportion of the capital loss to be attributed to each joint owner needs to be determined as a question of fact, typically based on each owner's contribution to the cost of the shares.

**4.28.** An individual who wants to claim share loss relief must do so within one year from the normal self assessment filing date for the year in which the loss occurs. This means that claims can still be made for share loss relief in respect of joint subscriptions or subscriptions through nominees for 2008-09 and later years.

*(HMRC Brief 41/10 11.10.10)*

### **Proving PPR**

#### ***The issue***

**4.29.** Whether a flat was used as a principal private residence.

#### ***The facts***

**4.30.** A market trader, F, purchased a flat in 1999. He transferred it to his son in June 2003. In his tax return, he did not declare any gain on the disposal. HMRC issued an assessment charging CGT, and F appealed, contending that he was entitled to principal private residence relief under s223(3) TCGA 1992. He claimed he had occupied the flat during 2001 after temporarily splitting up with his partner, but had resumed living with her later in the year (and had subsequently married her).

#### ***The decision (FTT)***

**4.31.** The tribunal reviewed the evidence and dismissed the appeal, observing that F had produced no documentary evidence (such as bills, bank statements or correspondence) to show that he had occupied the property. F had failed to discharge the burden of proof that the property had been his only or main residence and so the appeal was dismissed.

*(Favell v HMRC TC 00642 23.8.10)*

### **PPR relief claim with no intent to occupy**

#### ***The issue***

**4.32.** Whether an individual had occupied a house as his principal private residence and accordingly whether PPR relief was available.

***The facts***

- 4.33. M and his partner Miss A (now Mrs M) bought a house with the intention of modernising it and living in it. M was an experienced plasterer and decorator and his father was a builder.
- 4.34. Their plan was that M would move into the property immediately and renovate while Miss A would 'gradually' move in as works were completed.
- 4.35. However, shortly after completion, the couple found that the neighbours were unruly and that the neighbours' property had a burnt fence, there were burning mattresses there and children and dogs were running around, apparently not being controlled. Because of this Miss A changed her mind and refused to contemplate moving to live in the property.
- 4.36. M was reluctant to abandon the plan for the property to become their home at some point and he started the renovations on that basis.
- 4.37. After approximately three months the work was complete but Miss A was still unwilling to live at the property. They then decided jointly to let it out. They did this at some time between February 2000 and the middle of that year. The property was let until its disposal in 2004.
- 4.38. M argued that he (alone) was living at the property as his residence during the period from the completion for approximately three months and that the property was therefore his PPR and qualified for PPR relief for three years and three months of the ownership period, with letting relief covering the remainder of any gain. He accepted that he had paid no council tax relative to that period of residence and that he had no other documentary evidence (such as receipts for water rates, home insurance, telephone bills, DVLA records or credit reference agency records) showing that he was resident in that period. He said that he had not been advised to keep any such documentary evidence and had not done so, making the point that seven years had elapsed before HMRC opened their enquiry (in 2007), and ten years had elapsed before the hearing took place.

***The decision (FTT)***

- 4.39. M could not produce any supporting evidence to his claims that he planned to live in the property as his principal private residence. The more reasonable conclusion from the evidence was that he occupied the property only to renovate it to a condition suitable for rental. Evidence was presented that he repeated the operation in another property three years later. The tribunal agreed with HMRC that M's occupation 'did not have the quality that turned mere occupation of it into its being his residence'.

- 4.40.** The tribunal said that M's evidence was 'unreliable, vague and sometimes inconsistent'. For example, he said that he carried out the renovations in the period from December 1999 to February 2000, but at another point in his evidence he said that during the renovations he was working late as 'it was summer time' and stayed light until late.
- 4.41.** The appeal was therefore dismissed.  
*(Jason Terrence Moore v HMRC TC 00710)*

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## 5. Inheritance tax

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### **Suing an adviser for wrong advice**

#### ***The issue***

- 5.1. Whether a solicitor could be sued for tax unnecessarily paid as part of a scheme to avoid tax.

#### ***The facts***

- 5.2. Wilton Antiques Ltd (Wilton) was a company in the ownership of the D-C family, in which shares were held by the late Mr D-C's executors (his daughters), and his widow, the testatrix. One daughter also held shares personally. At that time, the testatrix was the sole surviving director. A loan of £300,000 was due to her from the company.
- 5.3. The defendant firm had acted as the family solicitors for the D-C family for many years. The daughters and the firm agreed that the widow's loan would be converted into equity with the advantage that, whereas the loan would be valued in her estate at £300,000, shares in Wilton would be subject to business property relief, so there would be an IHT saving. The requisite paperwork for a rights issue of 999,733 shares of £1 each was prepared, and the widow was allotted 300,000 shares which she took up in satisfaction of her loan account (the rights issue shares). The executors took up the allotment of 202,465 shares to which the estate of the late Mr D-C was entitled. The daughter did not take up any of the 497,268 shares that were allotted to her personally under the rights issue, and the firm prepared a letter of renunciation in favour of the widow (the renunciation shares), which she took up using funds from her free estate.
- 5.4. It was subsequently decided to raise a further £1m for Wilton. The firm prepared the paperwork to achieve that; however on that occasion it did not utilise the mechanism of a rights issue, but proceeded by way of an offer of shares for subscription. The widow subscribed for all of the shares on offer (the subscription shares), paying for them using £1m from her free estate, on the footing that they would attract BPR. Two days later, she died. Under the terms of her will, a residuary trust fund was constituted, divided into ten parts, being held in trust for the daughters and their children.
- 5.5. Following her death, it was discovered that BPR was not available in relation to most of the shares which she had acquired under the rights issue and the offer for subscription. Normally, business property had to be retained for two years before it qualified for relief. However, if the shares owned by the widow could be identified with other shares previously owned by her, and those previously owned shares had been held for two years, then all of the shares qualified. That condition was only satisfied in relation to the 300,000 rights issue shares (on the basis that she had acquired them in the right of her

ownership of a holding of 750,000 shares), but was not satisfied in relation to the renunciation shares or to the subscription shares: those shares had been acquired by her for reasons unconnected with her existing holding - they had simply been bought. The daughters unsuccessfully appealed against HMRC's analysis of the position.

- 5.6. The daughters and the other beneficiaries commenced proceedings against the firm and its LLP, seeking to recover damages to compensate them for the sum chargeable as inheritance tax upon the shares acquired by the testatrix in respect of which no BPR was available.
- 5.7. The firm submitted that the claimants' statement of case disclosed no reasonable grounds for bringing the claim, and alternatively, that there was no real prospect of their succeeding on the claim, and there was no other compelling reason why the case should be disposed of at trial.

#### ***The decision (ChD)***

- 5.8. The court ruled that in respect of the contract claims, there was a serious claim for breach of contract. In respect of the tort claims, following the guidance in established authority and applying those tests, it was not appropriate in the instant case to strike out the claim.
- 5.9. Having considered the particulars of claim, the terms of the defence and the evidence filed on both sides, the firm had failed to discharge the burden upon it to demonstrate that the claim was fanciful.
- 5.10. The application for summary judgment would be dismissed.  
*(Vinton and others v Fladgate Fielder and another ChD 30.4.10)*

#### **Mixed domicile marriages and gifts with reservation of benefit**

- 5.11. The limitation of the spouse exemption (on a lifetime basis) to £55,000 in s18(2) IHTA 1984, where the transferor spouse is UK domiciled but the transferee is not is well known. However, what might not often be thought about is that, in the case where the £55,000 threshold is exceeded, the exemption from the GWR regime in s102(5) FA 1986 does not apply. So if a UK domiciliary gives his house to his non-UK domiciled wife, and the house is UK *situs*, the value of the house remains in the husband's estate.  
*(Peter Vaines speaking at the IBC's IHT conference 18.5.10 reported in MTR June 2010)*

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## 6. HMRC

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### Payroll online: in-year penalties

- 6.1. Employers with 50 or more staff have been required to file their end of year returns online for some time now, but this year the requirement was extended to include forms P45 and P46. The following forms must be filed online:
- P45 (Part 1): details of employee leaving;
  - P45 (Part 3): new employee details;
  - P46: details of employees starting work who do not have a P45;
  - P46 (Pen): new pension details; and
  - P46 (Expat): details of those seconded to work either wholly or partly in the UK whilst remaining employed by an overseas employer.
- 6.2. However, penalties for failing to file the forms online have not been charged thus far, to give employers time to adjust to the new system. From December 2009, warning letters will be issued to employers who were required to file online but who have filed paper versions of the forms in either Quarter Two or Three of the current tax year. The warning letters will highlight the need to file online, but will only be issued in respect of a single form, rather than all of the defaults, as they are intended to serve as a flag to employers prior to the implementation of the penalty regime.
- 6.3. From 6.1.10, forms filed on paper by employers who are required to file online will be subject to a penalty ranging from £100 to £3,000, although the penalty notices will not be issued until April 2010.
- (Rebecca Benneyworth writing on AccountingWeb 12.10.09)*

### PAYE spring changes

- 6.4. HMRC have reminded all employers that, from this year, they must file their annual returns online by 19 May. There is no longer a paper option for small employers. Filing on paper, even before 19 May, could result in a penalty.
- 6.5. Also from May 2010, HMRC are introducing new penalties for late payment of PAYE; this includes income tax, national insurance contributions, student loan deductions and construction industry scheme deductions. Under these changes, employers may incur penalties if they fail to make PAYE payments on time and in full. The penalties will be

calculated as a percentage of the amount paid late and, for in-year payments, the percentage charged increases as the number of late payments in the year increases.

- 6.6. Employers who think they may have difficulty paying should call HMRC's Business Payment Support Service before the payment is due. If they do, and HMRC agree time to pay, they will not charge late payment penalties provided the business keeps to the agreement.

*(HMRC press release 10.2.10)*

#### **Reasonable excuse: HMRC information**

##### ***The issue***

- 6.7. Whether a partnership could rely on misleading information on the HMRC website as a reasonable excuse.

##### ***The facts***

- 6.8. A partnership submitted its tax return for the year ending 5.4.08 on 13.1.09 in paper form. HMRC imposed penalties of £100 on each partner on the basis that the due date for the return was 31.10.08. The partnership appealed, contending that it had a reasonable excuse because HMRC's website stated that 'if all the tax due has been paid by 31 January the penalty notice will be issued in the sum of nil as the penalty cannot exceed the amount of tax outstanding at 31 January'. Their evidence, not disputed by HMRC, was that they were given the same advice by the HMRC helpline.

##### ***The decision (FTT)***

- 6.9. The tribunal allowed the appeal holding that the information on HMRC's website was incorrect because s93(7) TMA 1970 only applied to personal returns and not to partnership returns, and was 'only applicable where the liability on the return is less than the standard penalty and does not apply to situations where the liability to tax is greater than the standard penalty but the taxpayer has discharged it on or before 31 January'. However the tribunal found that reliance on HMRC's website was a reasonable excuse, since 'HMRC has responsibility for gathering the correct amount of tax and it must be reasonable for a taxpayer to rely on HMRC's guidance as a correct statement of the law. Further, it is actually HMRC who impose the penalty: HMRC must therefore ensure that they do not mislead taxpayers into mistaken actions which incur a penalty'.

*(B & J shop fitters v HMRC TC00390 15.1.10)*

#### **Late filing: paper partnership return**

##### ***The issue***

- 6.10. Whether not understanding instructions on a tax return relating to the need for third party software was a reasonable excuse for the late filing of a partnership tax return.

***The facts***

- 6.11. D filed partners' personal returns electronically using HMRC software and, at the same time filed the partnership return on paper, on 31.1.09. HMRC raised a £200 penalty relating to the late partnership return and D appealed, arguing that he was aware of the need to file the return electronically, had decided to file the return in that way and had registered with HMRC to be able to do so.
- 6.12. However, on 31.1.09 when he attempted to submit the return online he found that, unlike the personal returns, he was unable to do so without third party commercial software which he did not have. Once he realised that he could not file electronically, he posted a paper version to HMRC.
- 6.13. Although he accepted that the return did 'indicate' the use of third party commercial software to file online, D said that he understood this to be an option not a requirement as the words used in the notice were ambiguous and not clearly stated.
- 6.14. He contended that this would not have been the case had the notice on the return stated that it could 'only' be submitted online by using third party commercial software.

***The decision (FTT)***

- 6.15. The tribunal accepted D's contention in respect of his understanding of the words used and found that he had a reasonable excuse for failing to file the return on time.  
(*Davies Software Services v HMRC TC00428 31.3.10*)

**Reasonable excuse: HMRC representation*****The issue***

- 6.16. Whether an agent's reliance on general representations made by HMRC constituted reasonable excuse for late filing of a partnership return.

***The facts***

- 6.17. The agent for a husband and wife partnership encountered difficulties in using software to make a partnership return for 2007-08 and decided to file the return on paper. In both a telephone call in 2008 to the HMRC helpline and in face to face conversation with staff in the HMRC local office, he was told that penalties for late filing could be avoided if all tax was paid by the due date. However on neither occasion did he specify that he referred to a partnership return. The return was filed on paper on the last working day of January 2009.

***The decision (FTT)***

- 6.18. The tribunal accepted that the agent had an honest belief that the penalty for a late partnership would be cancelled; however he was not specifically told this by HMRC, but

merely assumed that there was no difference between individual and partnership returns. This did not amount to a reasonable excuse. The agent claimed that another client in similar situation had had a penalty cancelled and that HMRC should therefore do the same in the present case; the tribunal rejected this suggestion.

*(Beebe v HMRC TC 00559 14.6.10)*

### **HMRC formally launches tax toolkits**

- 6.19.** After a year of development and testing, HMRC have introduced their range of self assessment tax toolkits for agents.
- 6.20.** The toolkits highlight the common errors that attract HMRC's attention and the steps that can be taken to reduce those errors. They can also be used to help demonstrate that 'reasonable care' has been taken. They consist of a checklist, explanatory notes and links to further guidance. There is no obligation to use a toolkit.
- 6.21.** The first toolkits to be released were:
- capital gains tax for trusts and estates;
  - marginal small companies' relief;
  - capital allowances for plant and machinery;
  - personal and private expenditure; and
  - capital gains tax for land and buildings.
- 6.22.** An IHT toolkit was originally included in HMRC's plans, but failed to make its public debut alongside the other five. With the possibility of a much higher IHT threshold, perhaps the development team decided to wait until the dust settles before tackling that one – although Conservative pledges to reform capital allowances didn't hold up the plant and machinery toolkit.
- 6.23.** The toolkits will be updated to reflect new legislation and HMRC said they plan to develop more.
- 6.24.** The concept behind each toolkit is to focus on the issues where HMRC see the highest risk of mistakes occurring. Each toolkit starts with an introduction, followed by a detailed checklist and supporting guidance.
- 6.25.** In some cases the explanation will show HMRC's view of the correct treatment, which may be an interpretation of the law rather than a simple statement of law.

- 6.26.** Agents will be able to use the toolkit to satisfy themselves before a return is submitted that they have addressed the key risks HMRC would look at in any compliance check. The toolkit should reduce the number of overall errors and support the department's strategy to ease off on those who want to pay the correct amount of tax so it can target its compliance efforts on those who deliberately underpay.
- 6.27.** Businesses and agents using the toolkits will be able to demonstrate they were taking more care with their tax so even if a return was subsequently found to be incorrect, no penalty could apply if they had correctly used one of HMRC's tools.  
*(HMRC website 17.5.10; Accounting Web 20.5.10)*

#### **HMRC to publish six more toolkits**

- 6.28.** HMRC are to publish a further six compliance toolkits this year. The first six toolkits were launched on 17.5.10 following very positive feedback from the pilot which ended on 31.1.10.
- 6.29.** The six new toolkits to be launched will be:
- capital v revenue;
  - losses;
  - VAT input tax;
  - directors (*sic*) loan accounts;
  - inheritance tax; and
  - benefits from employment.
- (HMRC website 3.8.10)*