AAT Tax Update 2014

Introduction

1.1 Legal background

This series of lectures lecture has been prepared using the legislation and recent case law up to 31 March 2014. In addition, the Finance Act 2013 has been reviewed as has the Chancellor's statement in December 2013 and the budget 2014.

This voluminous addition to the UK tax legislation is not thought to affect any of the ideas and principles within this paper. A new General Anti Abuse Rule (GAAR) is included in the FA 2013 but the planning points within this paper are all designed to achieve a commercial objective in a tax efficient way. As tax avoidance is not the driver, the GAAR should not affect in any way the contents of this paper. However, 'mission creep' in the application of our law has been and remains a problem so this is an area of developing law which needs to be considered before any transaction proceeds.

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1.2 Objectives and Content

This series of lectures aims to update AAT members in practice and cover recent important changes in the law and practice of tax within the UK. There are detailed notes which contain additional links should attendees wish to research further the developments including links to the actual published judgements and further commentary and articles.

The workshop examples are designed to explain the practicalities of computations, ensuring that the attendees can perform basic calculations and check that computer software automatically generates the right result.

Chapter 2

2. Budget 2014 Key points

2.1 Personal Taxes

On 19 March 2014 I sat down to listen to the Chancellor, George Osborne,MP , and his budget speech which lasted approximately one hour. Much of what he said had been said before but he did produce the occasional rabbit from the hat surprising listeners and tinkering with the system.

The point at which people start paying income tax will be raised to £10,500 from April 2015. In the last few years this increase in personal allowances has been achieved by narrowing the basic rate band which brings more people into paying higher rate tax

Threshold for 40p income tax to rise from (2013/14) £41,450 to (2014/15) £41,865 from 5 April 2014 and by a further 1% to £42,285 next year (2015/16). The basic (20%), higher (40%)and additional rates (45%) of income tax for 2014-15 will remain at their 2013-14 levels. (Finance Bill 2014)

The government will simplify NICs for the self-employed by collecting class 2 NICs through Self Assessment from April 2016, and will implement OTS recommendations to simplify the taxation of employee benefits and expenses, employee share schemes and partnerships.

Inheritance tax waived for members of emergency services who give their lives in job. But the nil rate band remains the same at £325,000 and the smaller reliefs detailed in Chapter 6 remain the same

Tax on homes owned through a company to be extended from residential properties worth more than £2m to those worth more than £500,000. Buying a new home using a limited company could now face a 15% SDLT charge unless one of the exemptions apply and reducing the threshold to £500,000 from April 2016 is a very significant change. We'll need to see what Scotland does with its different land tax.

There was good news for savers especially with the proposed simplification of ISAs. Cash and shares ISAs are to be merged into a more flexible single new ISA (a NISA) with annual tax-free savings limit of £15,000 from 1 July 2015. Currently savers can only invest £5,760 a year into a cash ISA.

Investors will now be able to transfer funds from previous ISAs - either cash or stocks and shares - into NISAs.

The 10p rate for savers applied on the first £2,790 of savings income above the personal allowance (£9440). The 10p tax rate for savers abolished by reducing it to zero. And expanding this zero band to £5000 from 2015 onwards.

The cap on savings in Premium Bonds will be raised from 1 June 2014 allowing, savers to hold up to £40,000 in Premium Bonds, up from £30,000 previously, and in 2015 the limit will be raised further to £50,000.

The amount of income that one half of a married couple can transfer to their partner will be set at £1,050 for 2015-16.

I was surprised by the announcement of change to defined contribution pension schemes. These changes will come into force from April 2015. All tax restrictions on pensioners' access to their pension pots will be removed, ending the requirement to buy an annuity not later than age 75. The taxable part of pension pot can be taken as cash on retirement to be charged at normal income tax rate, down from the current punitive rate of 55%.

As a first step towards this reform, the Budget introduces a number of immediate changes, to allow people greater freedom and choice now over how to access their defined contribution pension.
From 27 March 2014 the government will:

- reduce the amount of guaranteed pension income people need in retirement to access their savings flexibly, from £20,000 to £12,000
- increase the capped drawdown limit from 120% to 150% to allow more flexibility to those who would otherwise buy an annuity
- increase the size of a single pension pot that can be taken as a lump sum, from £2,000 to £10,000
- increase the number of pension pots of below £10,000 that can be taken as a lump sum, from 2 to 3
- increase the overall size of pension savings that can be taken as a lump sum, from £18,000 to £30,000

New Pensioner Bond, paying "market-leading" rates, available from January to over-65s, with possible rates of 2.8% for one-year bond and 4% for three-year bond - up to £10,000 to be saved in each bond

Anyone wishing to read the full speech can follow:
https://www.gov.uk/government/speeches/chancellor-george-osbornes-budget-2014-speech

There are five books with a total of 407 pages which are available from the Treasury website giving the full detail of the 2014 budget which you can access at:
https://www.gov.uk/government/publications/budget-2014-documents

The Finance Bill was published on 27 March 2014 and at 601 pages it can hardly be described as a riveting good read. It is in two volumes and there are 117 sections and a further 34 Schedules,

http://www.publications.parliament.uk/pa/bills/cbill/2013-2014/0190/14190.pdf

This was a political budget with most of the good news postponed until 2015 but there were a few rabbits which appeared out of the hat. The one on pension reform, doing away with the need to buy an annuity and giving greater access and flexibility to defined contribution schemes was interesting. You can read more about this at:

https://www.gov.uk/government/news/pensions-freedom-for-400000-hardworking-people-from-today

As set out in the Overview of Tax Legislation and Rates (OOTLAR) legislation will be introduced during the passage of Finance Bill 2014 on the following measures:

- Bank levy redesign (banding model), which is subject to a consultation
- Theatre tax relief, which is subject to a consultation
- UK oil and gas: bareboat chartering – draft legislation will be published on 1 April 2014, the date from which changes will have effect

The government has also published guidance and technical notes on the following measures:

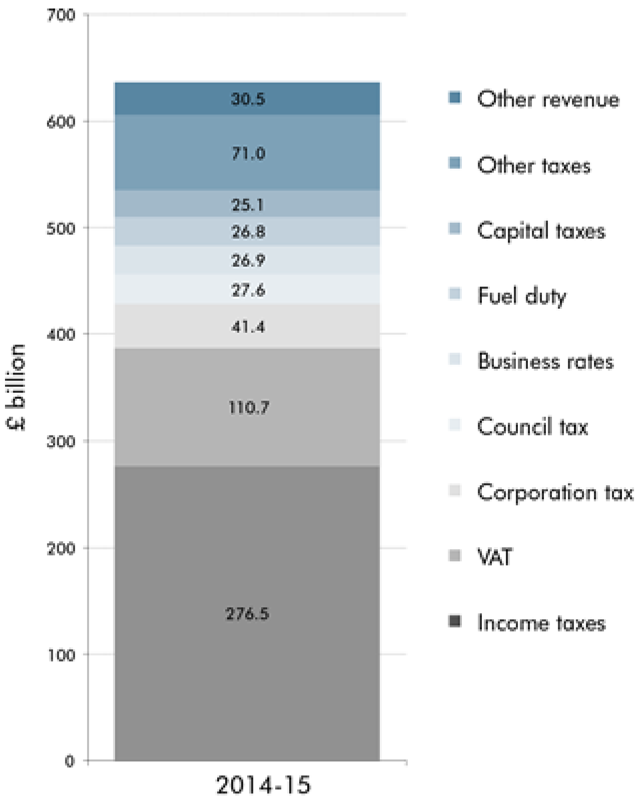
- Social investment tax relief
- Partnerships: mixed membership partnerships; alternative investment fund managers; transfer of assets and income streams through partnerships
- Partnerships: salaried member rules

You can download the guidance from:

https://www.gov.uk/government/publications/finance-bill-2014-legislation-explanatory-notes-and-guidance

2.2 The Public Finances

Government spending is expected to be £732 bn in 2014/15 but the income for taxes is a mere £648 which means we need to borrow £84bn to make the books balance. The OBR publishes a helpful analysis of how the receipts to the consolidated fund arise (see chart 1 Below).



Source: OBR, HMT

Despite this, growth is forecast to strengthen and the Chancellor aims to stop borrowing and run a tiny surplus by 2018/19. Viewed simplistically, the UK is in a mess and borrowing is too high.

Unemployment continues to fall with a new future target of 5% and the number of benefit claimants continues to decline. CPI has been targeted at 2%

2.3 Corporate Taxes

The main rate of corporation will be reduced to 21% from April 2014 and 20% from April 2015.

The small company rate which applies to a company without any associated companies with a profit of less than £300,000 remains at 20%

2.4 VAT

From 1 April 2014 the VAT registration threshold will be increased from £79,000 to £81,000 and the deregistration threshold from £77,000 to £79,000.

I remember reading some VAT tax cases on the zero rating of cars adapted for wheelchair users and recognizing that with VAT at 20% the potential for abuse was considerable. A wheelchair user could buy an expensive car and then faced the temptation of selling it quickly at a considerable profit. Of course this has all the hallmarks of trading but in the cases which I read the HMRC confronted the dealer (whereas in my opinion they should have raised assessments on the wheelchair user who was buying cars and avoiding the VAT on purchase.

I'd almost describe it as hidden away at page 76 of a 120 page report but paragraph 2.180 VAT: announces consultation on zero rate for adapted motor vehicles for wheelchair users – The government will consult on reform of the VAT zero rate relief on the supply of motor vehicles adapted for the use of wheelchair users, to seek to better target the relief and reduce fraud, and to ensure that users of lower limb prosthetics can benefit from the relief.

Chapter 3

Personal tax – Income tax, NICs, tax allowances etc

3.1. Income Tax rates and allowances

An article in the times dated 12 March 2014 predicts that over 1 million taxpayers will join the ranks of higher rate tax paying 40% or more in 2014/15 compared to 2010.

Members in practice (MIPs) will be aware that clients often want advice on how they can avoid paying higher rate tax and when an individual is approaching the threshold they often welcome advice on legitimate ways to reduce their taxable income.

	2013/14	2014/15	2015/16
PA	9,440	10,000	10,500
Basic Rate	32,010	31,865	31,785
Higher Rate Threshold	41,450	41,865	42,285
Top rate	45%	45	????

Tax planning is a sensible and prudent activity and when there are different ways to achieve a commercial objective it is sensible to ensure that the advice given helps the person to choose the option best suited to their needs. However, this course does not intend to comment or condone what appears to be totally artificial avoidance schemes that fails the author's smell test although some examples are considered in Chapter 7 and its workshop.

3.2 Employment income

Our tax system continues to grow more complex and, for example, few could have foreseen that when PAYE was introduced in 1944 and imposed an obligation on employers to deduct tax at source, that system would now require the employer to report real time information (RTI) whenever payment is made to an employee. There continues to be arguments about what constitutes payment and in other cases the valuation of certain things.

Employers have had the burden of collection of tax imposed upon them and in some cases that burden must be close to if not past the hurdle of violating the individual's human rights. Certainly recent legislation has increased what the government expects to be normal civic duty.

Self-assessment in respect of income and capital gains was introduced for individuals, partnerships and trustees, etc. from 1996–97. Under self-assessment, the taxpayer submits the appropriate return, calculates his own tax liability (unless the return is submitted by 31 October after the end of the tax year for the Revenue to calculate the tax due), and pays the tax due without waiting for assessment with the final payment due not later than 31 January following the fiscal year end.. Payments of tax on account are made within the tax year itself.

Since its introduction the penalty regime has been stiffened considerably with fixed penalties applying for late filing even if not tax is actually due (schedule 55 FA 2009).

For many businesses, the biggest single cost is that of employing staff. The remuneration of employees and directors is allowable in the computation of taxable profit to the extent that it is wholly and exclusively incurred for business purposes. This includes bonuses, gratuities, payments in respect of removal, etc. expenses, benefits in kind, medical insurance premiums, etc. Remuneration paid to members of the employer's family is allowable in the same way as payments to other employees. It has to be shown, however, that the money claimed to have been paid was in fact paid to and received by the employee (Abbott v IR Commrs (1995) Sp C 58).

3.2.1 Profit extraction Beware the settlements legislation. In Arctic Systems Ltd, the company and its owners, Mr & Mrs Jones must have incurred huge legal costs in successfully determining that in their case the settlements legislation did not apply and that the income allocated to each spouse was correct. Arctic Systems Limited was owned equally by Mr Jones and his wife. Mr Jones was the sole director and his wife was company secretary. The company's only business was the supply of computer consultancy services which were performed only by the husband; Mrs Jones performed company secretarial and administrative services only. In some years, company paid modest salaries to both husband and wife and in some years more substantial dividends were paid equally to husband and wife.

The principal issue was whether the dividends paid to Mrs Jones consisted of income arising under a settlement of which Mr Jones was the settlor so that they should be treated as his income under what is now ITTOIA 2005, s. 624. Arctic Systems Limited had been originally incorporated on 5 August 1992 by company formation agents as an 'off the shelf'; only two £1 shares were issued. On 11 August 1992, Mr and Mrs Jones acquired the company. Mr and Mrs Jones each paid £1 for their share. There were no subsequent changes in the issued share capital, shareholdings or officers of the company. The only year under appeal was 1999–2000 in which Mr Jones received a salary of £6,520, Mrs Jones received a salary of £3,600 and they both received dividends of £25,767 each.

The legal process of a tax appeal can be slow and expensive. It took until 2007 for the House of Lords to confirm the Court of Appeal decision that there had not been a settlement and that the tax to be assessed was as the couple claimed. HMRC and the government were not happy with this decision and hence my warning to beware the settlements legislation.

More recently, HMRC have succeeded at the FTT in showing that there was bounty and a settlement in the case of Donovan and McLaren. HMRC brings itself into disrepute when it uses the settlements legislation to challenge family arrangements and income sharing. HMRC's interpretation of the law ignores the clear policy statements made by the then Chancellor, Norman Lamont MP, when he was introducing the legislation for independent taxation. However, one can appreciate that certain aggressive arrangements need to be challenged especially when dividend waivers are necessary because otherwise there would not be sufficient retained profits to cover the whole dividend.

In Donovan & McLaren v Revenue& Customs [2014] UKFTT 048 dividend waivers were held to be a settlement. Mr Donovan and Mr McLaren each faced discovery assessments for the three tax years ended April 2008,2009 and 2010 for tax of approximately £13,800. Immediately I see a figure of tax that low I am concerned that there is no equality at arms because the appellants are unlikely to able to fund a contentious appeal.

Prior to 2001, the two gentlemen owned each 50% but then each gave their spouse 10% of the shares. A key finding of fact made by the first tier tribunal was that the company only held sufficient reserves if the earlier years' waivers were taken into account. The FTT took the view that to view the figures by ignoring previous waivers was artificial and that the cumulative effect of the arrangements should not be ignored. In those circumstances the FTT found that there was a lack of sufficient distributable reserves within the company were it not for the Appellants waiving the dividends.

The dividend waivers were not something which would have occurred on any arms length basis. The simple plan was to make use of the spouses' unused basic rate band by gifting income from the higher rate husband to the basic rate wife. The necessary element of bounty was there to decide that this was a settlement and the tax planning failed.

HMRC will be pleased by this victory but it is a persuasive authority only and not legal precedent. Practitioners advising their clients to share income amongst family members should ensure that there are sufficient distributable profits to cover the whole dividend before any waiver is considered to retain some of the profits within the company as working capital.

http://www.financeandtaxtribunals.gov.uk/judgmentfiles/j7541/TC03188.pdf

3.2.2 Recent developments Employers and their advisers face a difficult task in keeping abreast of developments and operating PAYE with all of the reporting requirements. On 19 February 2014 HMRC published Employer Bulletin Issue 46 (PDF 994K) which is now available. Aimed at employers and agents, it contains important information and news about topics which may affect payroll obligations to HMRC. At 40 pages it is worthwhile to download and read this bulletin the contents of which are listed below with the page number in bold on the LHS.

3.2.3 Status and HMRC challenges A significant risk area for many employers, especially in the construction industry sector is a mistake in the employment status of an individual. There is (currently) no statutory definition of self-employment and case law determines whether a contract is a 'contract of service' (employment) or a 'contract for services' (self-employment). A worker's employment status, i.e., as employed or self-employed, is not a matter of choice. Whether someone is employed or self-employed depends upon the terms and conditions of the relevant engagement. The tax and National Insurance contributions (NICs) rules do, however, contain some special rules that apply to certain categories of worker in certain circumstances. A worker's employment status will determine the charge to tax on income from that employment or self-employment. It will also determine the class of NICs which are to be paid.

HMRC website provides an 'Employment Status Indicator (ESI) Tool' (www.hmrc.gov.uk/calcs/esi.htm). Employers and contractors may use the tool to obtain a HMRC 'view' of the employment status of their workers. In cases of doubt it is helpful to use the tool. Printing the result can provide evidential support that reasonable care was taken in a difficult area. Under the penalty regime which has applied since April 2009 (Schedule 24 FA2007) there is no penalty if a mistake occurs in a complex area of law.

HMRC issued a consultation document in July 2009 entitled ‘False self-employment in construction: taxation of workers’, proposing a set of statutory tests for self-employed status, see

www.hm-treasury.gov.uk/d/consult_falseselfemploymentconstruction_200709.pdf.

More recently they have announced their policy of enhancing the IR35 legislation. HMRC are conducting more reviews of businesses and taking a hardline approach, with the maximum penalty of £3,000 for each monthly statement displaying an incorrect status declaration. The gross payment status of each company (often vital for cashflow and stability of these businesses) is also put at risk.

This means it is critical that proper contracts for services are in place and that these reflect the actual reality of the situation. Subcontractors should adopt the appropriate business practices of issuing invoices and bearing a share of the financial risks, including maintaining their own insurance (and rewards) in this situation.

The legislation governing the taxation of employment income has since 2003 been contained in the Income Tax (Earnings and Pensions) Act 2003 (‘ITEPA 2003’). The ancient concept of ‘Schedule E’ was abolished and the term ‘PAYE income’ took the place of ‘income assessable under Schedule E’.

3.2.4 Employer reporting obligations RTI It was announced in Budget 2010 that the Government would consult with employers and payroll providers on mechanisms to support real time collection of PAYE information. Following consultation, amended regulations (the Income Tax (Pay As You Earn) (Amendment) Regulations 2012 (SI 2012/822)) came into force on 6 April 2012. They applied to the pilot employers with effect from the date on which the employers agreed to join the pilot. HMRC will have the option to require other employers to submit information using RTI, by issuing a direction, in order to phase introduction. The regulations required virtually all employers to submit information using RTI from 6 October 2013.

The switch to RTI means that employers and pension providers are obliged to report tax, NICs and other deductions to HMRC at the point they run their payroll rather than at the end of the year.

RTI reporting is designed to be embedded into an employer's or pension provider's normal payroll activity, with employer and pension provider returns integrated into payroll software. So each time employers run their payroll software it should automatically gather the information about employees' and pensioners' tax deductions that HMRC require. Many small employers report difficulties with RTI.

As employers and pension providers will send RTI returns to HMRC each time they run their payroll, employers should no longer need to:

- send an end-of-year return (P35s, P14s and P38As) to HMRC;
- complete or send a form P45 to HMRC when an employee leaves (but a form P45 will still need to be completed and given to an employee); or
- complete or send form P46 to HMRC when an employee joins.

Employers still need to give individual employees a P60 at the end of the year and to report benefits in kind using form P11D not later than 6 July following the end of the fiscal year.

3.2.5 National Insurance Developments On 13 March 2014, the National Insurance Bill received Royal Assent. There is a mixture of good news and bad news within this Act. The main provisions are:

- Schedule 1, National Insurance Act 2014 includes rules to determine whether an employer is connected with another to prevent the abuse of the employment allowance which gives from 6 April 2014 an allowance of up to £2,000 per employer,

- The GAAR applied to NIC from 13 March 2014,
- The power to reduce Class 1 NIC for employees under age 21 which will come into force from 6 April 2015,
- A deeming power to treat certain office holders as employees, and
- A power to change the law by the use of secondary legislation so that certain 'partners' are treated for the purposes of the NIC legislation as if they were employees

3.2.6 Deeming LLP partners to be employees Assuming the draft clauses which were exposed for consultation in December 2013 are enacted there will be new rules to treat certain partners of an LLP as 'Salaried Members'. The new rules are scheduled to take effect from 6 April 2014. Salaried Member are an individual who satisfies certain conditions and is to be treated, for corporation tax, income tax and NIC purposes, as being employed by the LLP thereby bringing the individual into taxation under ITEPA 2003 in respect of all earnings from that deemed employment. The individual's earnings would be subject to employer's and employee's NICs and, as employer, the LLP would be obliged to operate PAYE thereon. Correspondingly, the LLP would be entitled to a tax deduction for any expenses paid by it in respect of the employment.

ITTOIA 2005 s 863 treats the activities of a UK LLP as carried on in partnership by its members. HMRC believes that this has been abused and that many LLP partners are really employees. If the following three conditions are met then the individual is a Salaried Member for UK tax purposes.

> (i) the individual provides services to the LLP and is remunerated for those services to the extent of 80% or more by way of "disguised salary" the quantum of which does not vary by reference to the overall profitability of the LLP; and
>
> (ii) the individual does not have significant influence over the affairs of the LLP; and
>
> (iii) the member's capital contribution to the LLP is less than 25% of his "disguised salary".

"Disguised salary" is remuneration which is:

- fixed; or
- if variable, varies without reference to the overall amount of the LLP's profits or losses; or
- is not, in practice, affected by the overall amount of the LLP's profits or losses.

Frankly, I am concerned that this test is going to catch a lot of newly introduced junior partners who have a small fixed profit share at the start of their partnership. Fairly obviously, they are at risk of being caught by the second test as well so the determining feature might well be that third testThere is more on this topic in chapter 3 and there is a 63 page guidance note published by HMRC.

3.2.7 Tax Efficient Remuneration Packages As an employer (or adviser to employers) you need to make sure that the remuneration package offered, both helps to retain your best people and meets their needs in a tax efficient way. The following report seeks to describe some of the more common forms of tax efficient remuneration. The report has been written on the basis of the tax Law which was in force at 31 March 2014 but it has also tried to take into account anything in Finance Bill 2014 which might be relevant and other areas where announcements or consultations have promised change.

There is always a balance to be struck between the administrative cost and complexity of designing tax efficient and flexible reward schemes. Tax is subject to change and in recent years we have seen incentives introduced, varied and withdrawn. I suggest that tax efficiency should not be the driver but instead the commercial objective should be achieved in the most tax efficient manner but, wherever possible, in a way which can be changed.

Employer provided childcare is likely to change in 2015. From the Autumn of 2015 the new scheme will be available offering up to £2,000 at the rate of 20p support for every 80p incurred up to a maximum of £10,000. At present it looks like the old childcare voucher system may continue to be available to those already enrolled but the old schemes will be closed to new entrants. This may be excessively complex and a more likely outcome will be that the old schemes will be phased out.

Childcare Benefits: An employer can provide childcare vouchers of up to £55 per week (£243 per month) to employees free of tax. In order to qualify for tax exemption, the conditions to be satisfied are:

- Vouchers are offered in a scheme that is generally available to all employees or all those at a particular location.
- The childcare is carried out by someone who is registered or approved for that purpose.
- The employee has parental responsibility for the child and a person is only a child until the last day of the week which falls 1 September following the child's 15th birthday.
- The exemption limit applies to each employee and not to each child and to the tax week or month that childcare vouchers are provided to the employee.

There is no requirement to use the voucher in the week or month that it is provided. As a result, accumulated vouchers may be used to cover periods, for example school holidays, when higher childcare costs arise.

If an employer provides childcare in a nursery or play scheme on their premises or on premises provided jointly with others, no tax liability is due on the benefit to the employees. The employer must be wholly or partly responsible for financing and managing the arrangements and this is a risk that many employers are unwilling to assume. The care must be provided on premises which are not wholly or mainly used as a private house and the facilities must meet all local authority registration requirements.

Depending on the partial exemption position, management expenses fees which bear VAT may have the input tax denied because the supply deemed to occur is exempt.

Training There is no liability to income tax by virtue of:

- the provision for an employee of work-related training (or any benefit incidental to such training); or
- the payment or reimbursement to or in respect of an employee of:

a) the cost of work-related training or of any benefit incidental to such training; or

b) any costs of a kind specified in ITEPA 2003, s250(2), provided certain conditions are met (s250 (1) ITEPA 2003)

Section 250 (2) specifies the following types of exempt costs:

- costs which are incidental to the employee undertaking the training;
- expenses incurred in connection with an examination or other assessment of what the employee has gained from the training; and
- the cost of obtaining any qualification, registration or award to which the employee becomes or may become entitled to as a result of the training or such an examination or other assessment.

Section 250 (2) would cover expenses such as travelling and subsistence, which itself includes food, drink and temporary living accommodation, only to the extent that such expenditure would either have qualified for relief under sections 336 or 337 ITEPA 2003 or attracted mileage allowance relief if the employee had undertaken the training as one of the duties of his employment and the employee had incurred and paid the expense.

Perrin v HMRC 2008 SpC 671

Point at Issue:

Whether a trainee accountant training towards his ACCA qualification was entitled to deduct the expense of the courses from his emoluments.

Facts:

The good news is that Mr Perrin was successful in his examination but the bad news is that he failed to get a tax deduction.

He was employed by a firm of chartered accountants and his contract of employment with the firm obliged him to incur payments in respect of course fees and reference materials designed to enable him to qualify for ACCA. Mr Perrin made the payments and claimed a tax deduction arguing that they were incurred wholly, exclusively and necessarily in the performance of the duties of his employment and according to the contract of employment. In 2004/2005 he claimed a deduction of £2,492 and in 2005/2006 £2,591.

He was not paid for work at the weekend and some of the courses attended were held on Saturdays. Attendance at other days' courses was at the partners' discretion although once authorised it was mandatory.

Statutory Background: The Tax (Earnings and Pensions) Act 2003 (ITEPA) at Section 336 provides:

(1) The general rule is that a deduction from earnings is allowed for an amount if:

(a) the employee is obliged to incur and pay it as the holder of the employment, and

(b) the amount is incurred wholly, exclusively and necessarily in the performance of the duties of the employment

Argument:

In Snowdon v Charnock (2001) STC 152, the point at issue arose over a specialist registrar's trainee costs of psychotherapy sessions to obtain an additional qualification were held by the courts not to be deductible. Distinguishing this, Mr Perrin had to do the training course as an absolute condition of his employment. He was not taking the training course to do them better.

Decision:

Based on past decisions, one might have anticipated that this was a clear cut result. However the analysis of the decision makes it clear that it was very close to the watershed and some of the factors which pointed away from the nature of the job requiring the attendance at courses was the fact that some of the courses took place on Saturdays and his contract of employment made it explicit that he was not paid for attendance on Saturdays. In addition, study leave was granted at the discretion of the firm and paid leave to attend courses was discretionary. This led to the conclusion that the nature of Mr Perrin's job did not require the expenditure on the course even though it enabled him to do the job better with consequent benefit to himself and the firm. Even though attendance was required by his contract, the cost of attendance was not incurred in the performance of the duties of his employment. Mr Perrin lost but it would appear he came surprisingly close to success and perhaps being paid for Saturday attendance as well as being obliged to attend courses rather than given discretionary leave would have made the difference.

Commentary:

If the firm had paid the costs, it would have been deductible from the firms' profits and it would have qualified under s250 ITEPA 2003 so that there would not have been a tax charge on the employee. Doing it right saves tax and NIC.

SpC 557 Consultant Psychiatrist v Revenue and Customs Commissioners – [2006] STC (SCD) 653

Point at Issue:

Whether professional training expenses incurred wholly exclusively and necessarily in the performance of the duties of employment and therefore entitled to tax relief as a deduction against employment income.

Facts:

The consultant psychiatrist appealed against a closure to an enquiry into her tax return for 2003/04 denying tax relief on professional training costs of £9,118. Throughout 2003/04 the appellant was employed by the NHS Trust as a consultant psychiatrist in psychotherapy under a pre-2003 national consultant contract, part-time. Her job description set out the duties of the post and listed the following:

Essential qualifications – registered medical practitioner with membership or fellowship of the Royal College of Psychiatrists. This was held by the appellant.

Essential training – high training equivalent to CCST in psychodynamic and systematic psychotherapy. This was also held by the appellant.

Desirable training – experience of specialist higher training in psychodynamic or systematic psychotherapy or group psychotherapy.

The deduction was claimed in respect of training in psychodynamic psychotherapy, included under the heading of desirable training in the job description. The NHS Trust was extremely short of funds; as such the appellant incurred the training costs.

In addition to the requirements of the post, as a member of The Royal College of Psychiatrists, the appellant was required to carry out continuing professional development. Their policy for CPD stated that 20 hours of external and 30 hours of internal CPD continued to be the minimum annual requirement for its members. This was in addition to an expected 100 hours of reading or other self directed learning.

In a letter written by the appellant's head of department, it was stated that she was expected to engage in CPD. However, it was also stated that it was normal practice for the holder of this post to undertake the training, as apposed to it being a contractual requirement.

Decision:

The Commissioner concluded that the professional training expenses incurred by the employee were not wholly, exclusively and necessarily incurred in the performance of the duties of the employment. As such, tax relief was denied and the appeal dismissed.

The test for deduction of expenses by an employee is narrowly defined and has been interpreted strictly in the past. First the employee must be obliged to incur and pay the expense as a holder of the post, and secondly, it must be incurred "*wholly, exclusively and necessarily in the performance of the duties of the employment*".

Firstly it was held that there was no contractual obligation to incur the expenditure, even though the Commissioner accepted that the appellant may not have been recruited, had she informed her employer that she had no intention of undertaking the training in question. It was also held that she was obliged to pay some part of the expenses as part of her CPD requirements.

Secondly, the Commissioner analysed whether the expenditure was incurred "*in the performance of the duties of the employment*". It was found that the appellant was undertaking further qualification in order to continue to hold the employment, similar to the doctor in Simpson v Tate. In addition, like the psychiatrist in Snowdon, the training, including personal psychotherapy sessions, did not in any way constitute the performance of duties under her contract of employment.

If it was found that the expenditure was incurred 'in the performance of the duties of the employment', it would have been necessary for the Commissioner to consider the wholly, exclusively and necessarily test.

Commentary:

With the growing emphasis on meeting CPD requirements, cases such as this are extremely topical. It is of course important to undertake ongoing training to ensure your knowledge is kept up to date, thereby maintaining your professional qualification. However, this case serves to highlight that the narrow conditions of s336 ITEPA 2003 must be met where the employee pays for training.

In the case where work related training is provided by an employer, s250 applies. Here, there is no liability to income tax. Work related training covers training courses designed to improve or reinforce the knowledge and skills of the employee, where this is likely to prove useful in the performance of their duties and training that will serve to better qualify the employee. Had the Trust paid for the training, this would have been exempt from income tax.

The wider application in tax efficient remuneration. "Work-related training" is defined as any training course or other activity which is designed to impart, instil, improve or reinforce any knowledge, skills, or personal qualities which:

- are, or are likely to prove, useful to the employee when performing his/her duties; or
- will qualify or better qualify the employee to undertake the employment, or to participate in charitable or voluntary activities arising through the employment.

The training must relate to the employee's current employment or to a "related employment".

There is no restriction on the way the training can be delivered. Self-tuition packages, computer based training, distance learning, work experience or work placement and informal teach-ins are all acceptable as are more formal classroom based methods. It does not matter whether training is delivered internally or externally, or on a part-time or full-time basis.

All elements of genuine schemes will qualify. There is no need for the Training scheme to be arduous or unpleasant. So work related training schemes could include many things that the individual employee would really appreciate. Some ideas of training which benefit the employer and employee include:

- Where leadership and team skills are appropriate to the employee, participation in activities such as Outward Bound, Raleigh International, or Prince's Trust;
- Work related first aid and health and safety courses;
- Language training in preparation for overseas communication
- Driving lessons if the employee might need to drive on business
- Safe-driver training, taken up by those with a company car or an advanced motorist course including the examination to get the qualification
- Martial arts course leading to qualifications

It is almost inevitable that there is a boundary and that some courses may cross that boundary in part although be within the exemption for work related training in part also. For example, a genuine residential work-related training course is held in a hotel and the attendees remain at the hotel for a golfing weekend paid for by their employer. The costs of travel to and from the hotel and the costs incurred during the course are not taxable but the cost of the golfing weekend is clearly taxable as it is a reward. The costs would be apportioned. If the employer bore the cost of the golfing weekend, that would be reported on the P11D.

In May 2013 it was reported that Iceland had been challenged by HMRC for failing to report a benefit in kind when it sent 800 managers on a course on Customer Service which is provided by Disney Florida. The report suggests that HMRC are seeking a settlement of 2.5 million and HMRC contends that the trip was an assessable benefit in kind. I suspected that this case mightl come before the tribunal but the latest appears to be that it has been settled by agreement. It is a warning that HMRC believe that there is a watershed and will challenge when HMRC believes that a tax exemption is being abused.
http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/10090633/Iceland-boss-baulks-at-2.5m-Disney-tax-bill.html

Company cars: Having a very low emission company car may still be a valuable perk but in recent years it has been clear that the Government sees the taxation of employer provided cars as a risk area worth investigating and that the taxable potential remains considerable.

HMRC's interpretation and practice is to interpret the law strictly and does not reflect the spirit or intention of the law which is to be found at ss114 to 118 ITEPA 2003 (historically s157 -159, s168(6) and Schedule 6 ICTA 1988).

During the 1970s there was a substantial growth in the practice of providing a company car as part of an employee's remuneration package. The growth increased when many employers used the provision of a company car as a means of circumventing the successive pay policies of the labour government. At that time it also delivered a reward to employees in what was viewed as a tax efficient and effective form.. There were revalorations of the income threshold in 1974 (£2,000), 1976 (£5,000) and 1979 (£8,500) to ensure that the taxable benefit only applied to what was then higher paid employees. Inflation and a failure to revalorise the threshold has meant that many more employees became potentially liable to the complexities of the car benefit legislation but it is accepted this is a deliberate intention of Parliament.

With the reform of company car taxation in 2002, the tax consequences of owning a larger car were often punitive because the amounts being assessed as a benefit exceed by a considerable margin the commercial measure of the actual benefit being enjoyed. To counter this, some people tried to arrange matters to avoid the incidence of the car benefit charge.

In Vasili v Christensen (2003) Sp C 377, a director bought a five per cent interest in the car which his company provided to him, and the special commissioner decided that this was sufficient to take the car out of the special rules for company cars, with the result that the residual liability to charge applied instead. This decision was, however, reversed in the Chancery Division (Christensen v Vasili), with judgment delivered in March 2004. The judge identified various problems that would follow from the interpretation given by the special commissioner and concluded that in all the circumstances, on a proper construction of ICTA 1988, s. 157 (see now ITEPA 2003, s. 114(1)(a)) the section still applied to impose a charge to tax under the company car rules. This decision is persuasive authority but not legal precedent. Many commentators view the Chancery division as seriously flawed and not persuasive because it fails to respect the property rights of the individual

In **Samson Publishing Ltd & Messrs Fehler v Commissioners for HMRC, UK 2010 FTT 489,** the point at issue was whether vehicles jointly owned by the two taxpayers and their employer company gave rise to a benefit in kind and a scale fuel charge.

Facts:
The company does print sales and administration but does not occupy commercial premises with all trading taking place telephonically, at the premises of customers or at the premises of suppliers.

In 1998 the two Mr Fehler's were advised to purchase the cars they needed to use on company business jointly with the company. They owned a proportionate to private use share in the cars in question. This was disclosed on their return, the argument then being whether the car benefit legislation applied to tax them on a scale charge or whether they should be taxed under the rule of 20% of market value when first made available to them.

On 8 August 2000 a second hand BMW 328I was purchased for £16,995 jointly by the company and Mr N S Fehler. All documentation confirmed joint ownership.

Mr E J Fehler bought in January 2001, a new BMW 530I sport saloon. It had a personalised registration number 111EJF and he paid a personal deposit of £1,000 together with £16,400 personally. There was also a second hand Mitsubishi Pajero which cost £11,000 and which was funded by a personal deposit from Mr N S Fehler of £1,100 with the balance paid by the company.

At all relevant times both directors had other vehicles other than those part-owned by the company available to them for private use and used those vehicles for private purposes. Both individuals maintained accurate records of the mileage for which the jointly owned cars were used. Mr E J Fehler's private use was less than 40% and Mr N S Fehler used the vehicle 7% of total use for private use and the second vehicle 6% but latterly his private use was under 2%.

In April 2004 full ownership of the cars was transferred to the individuals.

In the company's return there is a note explaining that the motor car is owned jointly by the company with the balance sheet reflecting 95% of the vehicle's cost being the company's investment. There was also disclosure under the related party disclosures and in the case of Mr E J Fehler it made it clear that he owned 40% of the vehicle and 60% was owned by the company. There was no evidence to show how insurance was paid for, in whose name it was or any MOT documents, nor was there any evidence as to who paid for the maintenance of the vehicle.

Arguments:
It was argued that this case could be distinguished from Christiansen v Vasili 76 TC 116 in which the taxpayer had won before the special commissioners but lost an appeal to the High Court. In Vasili the

car was originally acquired entirely by the company which then sold a 5% share to Mr Vasili. In this case at the point of purchase the vehicles were under joint ownership. Further, in the case of Mr E J Fehler he had a 40% share in the vehicle. There was also an argument that because of their private use ownership the private use which actually occurred was similar to that suggesting that the relative proportions were correct and therefore no benefit in kind was enjoyed by either director. They had not received a benefit in kind but were making use of what was their own property.

There was a further point to this case because HMRC were seeking to impose a penalty under section 95 TMA 1970 on the basis that the individuals and the company had been negligent.

Decision:
Ms J C Gort, Tribunal Judge gave her judgement on 10 October and found in favour of the Revenue. She concluded that the situations did not distinguish the case from that of Vasili and she was bound by the High Court judgement that the section 157 and section 168B deeming provisions were wide enough to capture such vehicles with the car benefits legislation. This legislation is now reproduced between sections 114 to 118 ITEPA 2003 so the point of principle is relevant. She therefore found that Messrs Fehler were liable to be taxed on the car scale benefit charges and the company was liable to pay class 1A national insurance contributions in respect of the benefits enjoyed.

However, she concluded that there was no negligence on the part of the two Mr Fehler's. They were mistaken as to their correct method of accounting for their interest in the respect of cars but they had disclosed the position on the company return and not made any attempt to conceal it in any way. At the time they completed the earlier forms the Vasili case had been decided by the Special Commissioners in the taxpayer's favour and the High Court reversal did not occur until March 2004. She ruled that it would harsh to expect the Fehler's to have understood the effect of that decision and therefore there was no question of negligence. The penalties were therefore vacated.

In G R Solutions Ltd v Revenue & Customs [2012] UKFTT 234, the point at issue was whether an employee was liable to tax and the employer liable to class 1A national insurance in respect of a car initially purchased by the employee with a 90% interest subsequently transferred from the employee to the company.

Facts:
On 17 April 2004, Mr Hall, an employee and shareholder of G R Solutions Ltd bought a BMW X5 that cost £53,645. Subsequently but before the company's year ending 31 December 2004, he sold a 90% share of the car for £48,636. Mr Hall did not keep records of his business and private mileage (a fatal mistake). He made a 10% contribution towards the running costs of the car and the company did not report a car or fuel benefit on forms P11D.

HMRC determined that the company was liable to pay class 1A national insurance contributions in respect of car benefit and car fuel benefit in the sum totalling £19,726.42.

Argument:
Mr Hall argued that he had an absolute right to the vehicle as he acquired a 10% ownership of the car and paid 10% of all costs relating to the car to the company. His argument was therefore that he was entitled to the pleasurable enjoyment of an asset which he owned and that the car was not made available by his employer by virtue of his employment with the company.

HMRC argued that section 117 ITEPA 2003 creates a fiscal fiction. If a car or van is made available by an employer to an employee then unless one of the family exclusions applies, it is deemed to be made available by reason of the employment. HMRC relied on the High Court decision in Christensen v Vasili [2004] EWHC 476 in which the company bought the car and then subsequently transferred a partial interest to Mr Vasili in tenant in common. The argument was therefore that the company had made the car available to the employee when Mr Vasili acquired an interest in the car from the company which had previously been the sole owner. In Vasili the employee had no right to use the car until a right was bestowed on him by his employer.

Mr Hall had bought the car outright and therefore had a right to use the car without anything being bestowed on him by his employer.

HMRC argued that Mr Hall had 100% use of the car despite only owning 10%. Income tax is an annual charge and HMRC argued that it is necessary to consider for the purposes of section 114 ITEPA 2003 whether a car has been made available in a particular tax year. Even though the car is co-owned, it remains a single indivisible asset. Thus, argued HMRC, when an employee uses a shared car for private purposes, the employer's share of the car is being made available to the employee. This argument was upheld in Samson Publishing Ltd v Revenue & Customs [2010] UKFTT 489 when the directors purchased the car jointly with the employer.

What should be remembered is that none of the above decisions are decisions of precedent but would merely be persuasive authority and could be overturned if an appeal went to a higher court. However, in practice, it is unlikely that anybody would fund such an appeal to a higher court because the sums involved would not make commercial sense to pursue the appeal.

Decision:
The court decided that the expression used in the statute, 'made available' needs to be applied to the facts in each tax year in question rather than to the point in time at which property titles were established. In fact they say that the expression 'make available' should be applied to the point in time at which the vehicle is used, rather than the point in time at which it is purchased. The company owns 90% of the car and the employee owns 10% and if the employee uses the car privately then the company is making available its 90% share of the vehicle at that point in time.

The Tribunal decided that the benefit for the car and for the use of fuel was correctly chargeable under section 8 SSCA 1999.

The HMRC strict interpretation of the law can produce some outrageously unfair results. In Whitby and Another v HMRC (2009) UK FTT 311, the point at issue was whether cars that were being used by employees and were leased from the employer group were assessable to car and fuel benefits even though the employees were leasing the cars on an arm's length basis. This decision must be of considerable concern to employees of car leasing companies throughout the UK. The case was chosen as a test case. The total benefits being assessed on Mr Whitby over a six year period were £74,672 illustrating that the point at issue for individuals can have serious fiscal consequences.

The Tribunal decided that the vehicles were made available by the employer. Their employer had purchased the vehicles and therefore had the rights to make it available to the employee. Consequently Section 114 applied and was not excluded by Section 117.

By concession, HMRC allowed a deduction for the open market value rental payments made by the employees being allowed under Section 144 ITEPA 2003. The approved mileage rate under Section 229 ITEPA 2003 was disapplied because it was a vehicle made available by the employer and as such a company vehicle it can only benefit from the advisory fuel rates. This decision is accepted even though the Tribunal and the author feel sympathy for the taxpayers.

Similarly in Stanford Management Services v CIR (2010) UK FTT 98, the actual contracts between the company and the Daimler Benz supplier of the car established that the rights of ownership lay with the employer company. Despite the fact that all costs were borne by the directors as individuals with costs and each lease payment being charged to the directors' loan account, it is accepted that the contract lay between the employer company and Daimler Chrysler Financial Services who supplied the car. There was no evidence to support the company's claim that it acted as nominee of the individual directors.

HMRC succeeded in its arguments that the form and substance indicated the vehicles were supplied by the employer creating a full benefit in kind charge. Section 117 is a deeming provision that deems the car to be available by virtue of the employment whether it is or is not and the only available escape is if an individual has to supply the vehicle in the capacity of that individual and family circumstances. Again the author notes the concessionary treatment extended and approved at paragraph 49 of the decision giving a deduction for the costs borne by the user in the computation of the assessable benefit. This decision is also accepted although again the author has some sympathy for the taxpayers.

The latest development has emerged with the decision of *Cooper & Others (Leaside Timber and Builder Merchants Ltd) v Revenue & Customs [2012] UK FTT 439.* In this case, a parallel service partnership was funded in part by the partners contributing capital which enabled this partnership to buy cars. The sole income of the service partnership derived from the trading company. The service partnership charged a management fee for the services provided by the partners and three employees. The sole customer of the partnership was the limited company.

The partnership provided cars and the overhead expenses including fuel to each of the partners. Each partner faced a disallowance for the private use that they made of the vehicle and its associated running expenses but HMRC went a stage further and said that as two of the partners were directors of the building company the provision of the cars came from the directors' employment. This seems to be taking the fiscal fiction created by the car benefits legislation to an unacceptable extreme. The consequence produces substantial amounts of tax because the company owed class 1A National Insurance of around £70,000 and the individuals faced a tax bill of around £145,000.

The Tribunal confirmed that the partnership is independent from the company and carries on its own account to commercial business but that business is wholly dependent upon the company, its sole customer. The Tribunal took the view that the management fee paid by the company to the partnership was more generous than would pertain if independent parties were acting at arm's length. With this in mind, the Tribunal found as a fact that the management charges comprised some of the running costs and depreciation for the cars and so argued that the company made available the cars to the directors for private use.

This is of course an outrageous outcome but it shows that in applying the strict letter of the law taxation can be very unfair. The directors have been charged in part by a disallowance in the computation of the partnership profit for their private use but they now face a double charge under the benefits in kind legislation because the Tribunal has interpreted the words *"by reason of his employment"* as much wider than common sense would suggest. In this case, even though the cars were bought and paid for by a partnership which is quite separate from the company, the argument is that all of the costs of providing and fuelling the cars were being met by the company through the management charge that the company paid to the parallel service company.

This decision has the potential to affect commercial arrangements which have been put in place. A key finding of the Tribunal is that the fees paid by the company to the partnership were excessive if one applies a test of what would be commercially reasonable in dealings between independent parties acting at arm's length. The Tribunal concluded that the cars in question were made available and the car fuel provided to each of the individuals by reason of their employment by the company. Even though the individuals were meeting all of the costs of the vehicles from what was their own money, the Tribunal concluded that there is no basis for reducing the cash equivalent of the benefits received by the partners.

Members of a trading partnership which derives income from a trading company in which an individual partner or partners has a material interest need to take note of this decision. If you think you are affected, you should seek advice, as a matter of urgency, from an experienced tax adviser.

In principle, all employees who have saved their wages to buy and run a car could find themselves facing another tax cost on a car benefit. It won't happen if common sense prevails.

For practitioners advising clients to help them comply with their fiscal obligations, the previously mentioned cases confirm that HMRC are adopting an aggressive and strict interpretation of the law. There are two other obvious risk areas relating to cars and non compliance the first being pool cars which fail the strict tests and the second being dealt with later in the chapter on VAT being the prohibition on recovering input VAT on the purchase of a car which is used privately.

Cars which were not pool cars: There is evidence that HMRC have been challenging many businesses which claim that vehicles are pool cars. HMRC ask that milage logs be maintained for pool cars in sufficient detail to demonstrate that the tests have been passed. However, there is no statutory requirement to keep mileage logs but taxpayers may find this helpful by providing supporting evidence that the vehicle is used as a pool car.

There are five conditions, all of which must be satisfied in order for a car to be considered a pool car. These conditions are:

(1) The car was made available to, and actually used by, more than one of the employees;
(2) The car was made available, in the case of each of those employees by reason of the employees' employment;
(3) The car was not ordinarily used by one of those employees to the exclusion of the other;
(4) In the case of each of those employees, any private use of the car made by the employee was merely incidental to the employee's other use of the car in that year; and
(5) The car was not normally kept overnight on or in the vicinity of any residential premises where any of the employees were residing, except while being kept overnight on premises occupied by the person making the car available to them.

In Industrial Doors (Scotland) Ltd , let's simplify this case down and say that one of the arguments was about whether a BMW 5 Series car which carried a number plate 8BG was a pool car or might have been a car available to and used as a perk car by Mr Brian Gargaro. Best practice should be that the company should for each pool car maintain a mileage log that demonstrates the requirements of section 167 ITEPA 2003 but this is not a statutory requirement. In fact there were other expensive cars and therefore the issue was about tax and national insurance class 1A of £17,256 in respect of the period from 6 April 2001 to 5 April 2007.

The proprietor owned 60% of the company and on employing someone he made it clear that pooled cars were made available to each employee for business travel purposes only. According to the company, the use of pooled cars for private purposes was strictly forbidden. Brian Gargaro, Director of Industrial Doors Ltd owned 40% and he gave evidence along with two other long term employees that the vehicles were not used privately. There were no mileage logs available. The cars were used to visit customers, chase debtors and drive long distances on company business.

HMRC were able to produce surveillance evidence from a later period and the company accepted the cars were used by employees privately in that later period. However in respect of the earlier period, HMRC were unable to produce any evidence to rebut the evidence given by the director and the two employees. Accordingly, their evidence was accepted as credible.

My only observation is that I reckon in this case the company was very, very, very lucky indeed. In my cynical old age, I would have suspected that a BMW 5 Series car with a personalised number plate 8BG would, on the balance of probabilities, have created a strong presumption that the vehicle was used privately. For this case to have failed before the Tribunal seems to me to indicate a serious flaw in the process of decision making review by line manager and internal review not to mention the Appeals Unit officer who presented the case.

More recently, the taxpayer had argued that pool cars had to be removed from the business overnight because the vehicles' safety would be at risk if vandalism and theft. There is quite a lot of evidence that HMRC are trying to clamp down on any significant private use of allegedly 'pool cars'. In Vinyl Design Ltd & Ors v Revenue & Customs [2014] UKFTT 205, the issue was an appeal against a decision issued by HMRC on 5 October 2010 to charge Class 1A NIC for car and fuel benefits for the periods 1 August 2007 to 5 April 2010 inclusive as a result of vehicles being provided for two directors (Mr Hanmer and Mr Templeman) of Vinyl Design Ltd ("the Company"). There are three company cars, an Audi, Mercedes and an out of use Renault Laguna. The Audi is used by Mr Hanmer and the Mercedes by Mr Templeman and each car is supposed to be used only for business. The two directors have other cars which they can use for their private motoring. The cars are not left at the Company's premises due to issues of security and vandalism. The cars are taken to the directors respective homes at night. All fuel for the cars is purchased by the Company.

The company argued that the cars satisfy all the conditions of section 167 Income Tax (Earnings and Pensions) Act 2003 ("ITEPA 2003") to categorise them as pool cars.

HMRC had evidence that the vehicles are taken home each and every night which suggests substantial private use. When at the home of the director, they are available for private use and the journey home is private use. Accordingly, the company is due to pay Class 1A of NIC £7,743, Mr Hanmer is due tax of £2816 and Mr Templeman is due tax of £9394

The car benefits legislation is a tax trap for the unwary. The Audi was registered in 2003 and was purchased on a second hand value of £6,000 in 2006. It is said to be currently worth £2,000. Its price when new was £21,540. The Mercedes was first registered in 1996 and purchased in November 2004 for £3,000. It is said to be currently worth only scrap value. The list price when new was £42,050. In other words the tax bill is considerably more than the vehicles cost.

Hindsight is a wonderful thing and as soon as the taxable benefit exceeds the cost or value of the car, it would have been better to own these vehicles privately and perhaps claim mileage allowances.

On a balance of probabilities, the Tribunal thinks it more likely that the cars were used by the directors individually. There were two cars and two directors and no other employees. The legislation states that a journey between a person's home and their place of business is not a business journey it is ordinary commuting and private travel. The private use of the cars was not therefore incidental to the business use.

The tax and NIC sought by HMRC was therefore due. I cannot help but feel sorry for the appellants.

http://www.bailii.org/uk/cases/UKFTT/TC/2014/TC03345.html

Tax efficient remuneration is mainly common sense and making sensible use of the exemptions which are contained in the tax legislation.

A husband and wife trading using a limited company could arrange a significant package of benefits which might include:

- Contributions into a pension scheme
- Use of a very low emission company car with very low scale benefit
- Christmas party £150 each
- Training costs (Spanish lessons, martial arts and CPD)
- Professional subscrptions
- Free parking near place of work
- Incidental use of pool car (or van or double cab pick up truck)

- Bicycles
- Phone (1 each)
- Eye tests and corrective glasses for computer users
- Beneficial loans?? From 6 April 2014 the threshold of exemption on small loans made by and employer will increase from £5,000 to £10,000 and the official rate of interest drops from 4% to 3.25%
- Childcare vouchers and nursery care

This list is not exhaustive but it does demonstrate that sensible tax planning is alive and well. Structuring matters in the most tax efficient way can achieve substantial tax savings allowing greater 'take home' pay for the well advised.

To assist with the workshop, Changes from 2013-14

The lower threshold will be reduced from 120g/km to 115g/km.

The lowest appropriate percentages are still 0 per cent and 5 per cent. 10 per cent will now apply to cars with CO_2 emissions of 76g/km to 94g/km.

The appropriate percentage will increase by 1 per cent for all vehicles with CO_2 emissions between 95g/km and 215g/km, to a maximum of 35 per cent.

Changes from 2014-15

The lower threshold will be reduced from 115g/km to 110g/km.

The lowest appropriate percentages are still 0 per cent and 5 percent. 11 per cent will now apply to cars with CO_2 emissions of 76g/km to 94g/km.

The appropriate percentage will increase by 1 per cent for all vehicles with CO_2 emissions between 95g/km and 210g/km, to a maximum of 35 per cent.

Beneficial loan arrangements - official rate of interest for 2014-15
The Official Rate of interest, used to calculate the income tax charge on beneficial loans, has been announced for tax year 2014-15. The new Official Rate of interest of 3.25% will take effect from 6 April 2014.

Workshop Chapter 3

Question 1

A senior employee, who is not a director, is entitled to a salary of £120,000 a year. This is earned on a day to day basis. The employee is entitled to payment of 1/12th of the annual salary on the final day of each month.

The employer is in severe financial difficulties and does not make any payment of the January 2014 salary. To help the employer and to avoid losing the individual personal allowance, on 8 February 2014 employer and employee make a revised agreement. The agreement is that the employee will not be entitled to any salary for the period 1 January 2014 to 31 March 2014.

Q1 The senior employee will be taxed in 2013/14 on:

(A) £90,000

(B) £91,428

(C) £100,000

(D) £120,000

Q1: For the tax year 2013/14 the employee is liable to tax on employment income of the salary of £100,000. This is made up of £90,000 (9 × £10,000) paid to 31 December 2013 and the £10,000 that the employee became entitled to payment of on 31 January 2014.

The agreement made on 8 February 2014 does not exclude the unpaid January 2014 salary from money earnings as the agreement was made after the January salary was treated as received for employment income purposes. But the agreement does prevent any employment income tax liability arising on the February and March salary given up.'

Question 2

Charles Morton has been employed by Silvair Ltd for many years as a salesman. His sales area was expanded in April 2013 to include the Highlands of Scotland (previously he worked only in the central belt) and he was given a new company car, a Landrover Discovery HSE costing £53,995 with CO2 emissions of 213g/km

Charles was recently contacted by heir hunters and informed that after expenses he inherited £12,000 and he seeks your advice on what he might do with this money to reduce his tax bill..

Charles' salary is £80,000 a year but he was shocked to learn that his car benefit for 2013/14 was £18898 creating a liability to tax on the car benefit at 40% of £7559.2. His employers have offered to provide all the fuel for the vehicle in recognition that the business needs impose the necessity of having such a large powerful vehicle. Discuss what advice you would give Charles.

Q2 If Charles does nothing he is going to be faced with a BIK of £18898 because the emission level is at the maximum of 35% and in addition a fuel benefit charge of £7595. As that takes him over the £100,000 he starts to lose his personal allowance creating a potential marginal rate on £6493 of his income of 62% and tax due of £4025.66.

The fuel benefit charge does not look like good value unless Charles has an exceptionally high private mileage. The discovery has a claimed combined mileage of 35.3 mpg and on this basis Charles would need to exceed 44319 miles annual private motoring before it become beneficial.

Buying a 10% share in the car will reduce Charles' BIK to £17,148 which in turn reduces his tax bill by £700. That tax saving is the equivalent of a return of 14% on the maximum contribution of £5,000 and in addition, when the vehicle is sold he should recover 10% of the sale proceeds.

Question 3 John Philips is a pilot with Wingo-air and he has recently attended a course upgrading his flying skills to fly the new Boing Airgiant. It is a condition of Mr. Philips' contract of employment that if he leaves Wingo-air within three years he has to repay the cost of the course being £11,000

John has been headhunted by a major airline offering a huge increase in salary and much better working conditions.

If John pays the £11,000 to his employer Wingo-air, can he claim a tax deduction for the expense as being wholly, exclusively and necessarily incurred for his employment?

What advice would you give him?

Q3 Sadly Mr. Philips will not be able to claim a tax deduction for the expense of buying out the training costs.

A better arrangement would be to approach his new employer and agree that in the first year of his employment he will accept a salary sacrifice arrangement reducing his salary by £11,000 in return for his new employer paying the training costs of £11,000. This would be exempt under s250ITEPA 2003 and the new employer would be entitled to a tax deduction

In 2006 a case came to the Courts which concerned a couple of pilots who had to repay to their previous employer the training and costs incurred by that previous employer in respect of pilot's training in aircraft usage. Hinsley and Another v Revenue & Customs Commissioners, (2006) SpC 569 concerned commercial airline pilots who had received training free of charge from their employers but were required under their contract of employment to repay an element if they left prematurely. The pilots repaid their employer the training costs as was required by the contract of employment but were then denied a tax deduction for the sums they paid after they left the employment. The expense was not incurred in the performance of the duty as the obligation to pay arose from the termination of the contract. In addition, the expense was not necessary as each and every holder of the office was not required to make the reimbursement.

Anyone faced with a similar dilemma would be well advised to negotiate with their new employer, perhaps to even consider a salary sacrifice before final salaries are negotiated, that the new employer will reimburse the cost of the training done by the previous employer. Such an arrangement would be tax efficient but in the case of Hinsley, where the expense was met by the employee himself, it was not allowable for tax purposes. By getting the new employer to reimburse the expense, the payment so reimbursed would be tax free.

Chapter 4

Business Tax Update

4.1 Annual investment Allowance Clause 10 increases the maximum amount of the annual investment allowance (AIA) to £500,000 for an extended temporary period from 1 April 2014 for corporation tax (CT) and 6 April 2014 for income tax (IT) to 31 December 2015. The increase in the amount of the AIA is effective for expenditure incurred on or after 1 (or 6) April 2014. This creates complications with expenditure needing to be allocated into precise periods. For expenditure incurred on or after 1 January 2016, the maximum AIA returns to its previous limit of £25,000.

Where businesses spend more than the annual limit, any additional qualifying expenditure is dealt with in the normal capital allowances regime, entering either the main rate or the special rate pool, where it will attract writing-down allowances (WDAs) at the 18 per cent or 8 per cent rates respectively.

4.2 Tackling abuse of salaried partners Limited Liability Partnerships (LLPs) incorporated in the UK combine the organisational flexibility of traditional partnerships with the benefit of limited liability for
their members. In law, they are corporate bodies with greater resemblance to limited companies than to traditional partnerships. Specific tax legislation exists to ensure that they are treated as partnerships for tax purposes, rather than as companies.

HMRC have published a 63 page guidance note on how HMRC intends to tackle what it perceives is an abuse of the law leading to significant loss of tax and NIC at
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/298222/Partnerships_Salaried_member_rules.pdf

The Finance Bill 2014 ensures that LLP members who are, in effect, providing services on terms similar to employment are treated as "employees" for tax purposes. The NICs Act 2014 and associated regulations provide for the changes to NICs legislation that will take effect from 6 April 2014.

These rules do not apply to general partnerships or limited partnerships that are formed under Partnership Act 1890 and Limited Partnerships Act 1907 respectively.

There are three conditions which must all be met if the new rules are to apply,

Condition A is met where it is reasonable to expect that at least 80% of the total amount payable by the LLP for M's services in M's capacity as a member of the LLP will be "Disguised Salary".

Condition B is determined by the amount of influence and control that the LLP member has. This condition is met if the mutual rights and duties of the members and the LLP do not give M significant influence over the affairs of the LLP.

Condition C relates to a capital contribution This condition is met if M's contribution to the LLP is less than 25% of the Disguised Salary which, it is reasonable to expect, will be payable in a relevant tax year in
respect of M's performance of services for the LLP.

Existing members who might otherwise be caught are given three months to satisfy the capital contribution rule and new members are given 2 months to get the finance in place to satisfy the capital contribution rule.

4.3 PAYE for employers: Advisory fuel rate updates HMRC published on 27 November

revised advisory fuel rates to operate from 1 December 2013. A newsletter might be apt reminding clients and/or employers of the change. The rates have reduced which is something many employers may welcome but about which employees might not be too pleased. For example diesel cars have changed from 12/15/18 p a mile to 12/14/17 p a mile. Similarly, petrol cars have moved from 15/18/26 to 14/16/24 p a mile.

Now I must admit to being cynical about these fuel rates which are supposed to be a deregulatory relaxation to help employers. My cynicism arises because in June 2012 the rates were 12/14/18 p a mile and the price of diesel in my local garage was exactly the same as it is now(£1.379) but it can be 10p a litre dearer on motorways and at remote garages.

Living in Scotland, I know that when the temperature drops, my fuel economy drops by over 20%. That means that if I were driving a company car, I'd be out of pocket by several pence each mile if my employer reimburses me business miles using the advisory rate. When HMRC have reduced that rate by 1p a mile at a time of year when the cold weather adversely affects engine performance, the change seems to me like a recipe for raising extra tax or creating an unhappy workforce.

4.4 The wholly and exclusively test will be strictly interpreted. A business must pay tax on the full amount of its profits. This can lead to disputes on income recognition but the more common area of dispute, especially in the case of small businesses with proprietorial involvement is on the expenses side.

With the AIA set to move to £500,000 disputes on the Capital/ Revenue divide can be expected to reduce unless the asset does not qualify as plant and machinery.

Any duality of purpose is strictly fatal to a claim to deduct a business expense and some recent cases demonstrate that HMRC will interpret the provisions strictly.

4.4.1 Actor Tim Healy's claim for rent expenses remitted back to the FTT

It was a surprise (to me) when the First Tier Tribunal (FTT) found in favour of Tim Healy that the accommodation expenses of £32,503 , representing the rent payable under a tenancy agreement for a period of nine months whilst Mr Healy was appearing in stage production of Billy Elliot in London, were incurred wholly and exclusively by Mr Healy for the purposes of his profession. The FTT allowed the expense under section 34(1)(a) of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA")

Mr Healy was based in Cheshire and was engaged to appear in the musical Billy Elliott from December 2004 until 17 September 2005 needed to find accommodation in London near the Victoria Palace Theatre, where the musical was running. All practitioners should be familiar with the series of tax cases which demonstrated that any duality of purpose would be fatal to a claim for a tax deduction.

The Upper Tribunal (UT) held that the First-tier Tribunal had made an error of law in that it did not consider the question as to whether the shelter and warmth that inevitably follows from arranging accommodation was more than incidental to the business purpose. However, the UT rejected HMRC's argument that the fact that the flat was rented for nine months meant that the taxpayer must have had a dual purpose. So the UT decision is to remit the case back to the FTT which needs to consider whether the duality of purpose will disallow the claim.

I feel sorry for Mr Healy because he was unable to obtain an adjournment to let him appoint and brief counsel so I think that there was an inequality of arms because his accountant took the appeal and was faced with a QC. Mr Healy had delayed giving formal instructions to proceed after the hearing dates had been fixed because of his concerns about the costs implications and he then became engaged on other matters, including having to deal with his divorce. I sympathise with Mr Healy here. He is faced with what can be considerable costs relating to litigation and it all happened 9 years ago. The potential costs should he lose will probably exceed the tax due if the claim fails.

The UT decided that there was no good reason given why there was such a long delay in reaching a decision to proceed and why there had been no earlier communication with HMRC and the Tribunal on the issue. To adjourn the matter at such a late stage would cause a significant delay in finalising the matters and would be likely to result in an increase in HMRC's costs.

The UT therefore concluded that it was in the interests of justice to proceed with the hearing.. Frankly, I think that decision stinks but it should be a warning to all potential litigants to be prepared to see any tax appeal through to its conclusion. But in fairness to the UT, the appeal has been remitted back to the FTT and that gives Mr Healy the opportunity of presenting his arguments better that he incurred the expense wholly and exclusively for the purposes of his self employed acting profession. I doubt that he will succeed.

http://www.tribunals.gov.uk/financeandtax/Documents/decisions/hmrc-v-tim-healy.pdf

4.4.2. Legal Costs of a partner were allowed for tax

In Peter Vaines v The Commissioners of Revenue & Customs [2013] UKFTT 576, Mr. Vaines claimed £215,455 as a tax deduction which related to a payment made in settlement to Bayerische Landesbank under an agreement made by a number of individuals who were connected with the law firm Haarmann Hemmelrath. Haarmann Hemmelrath had ceased to trade and owed approximately €17 million to Bayerische Landesbank and other banks. Until 31 December 2005 the Appellant had worked in the London office of the law firm Haarmann Hemmelrath which had many offices, in Germany and elsewhere.

At all material timesMr. Vaines was a partner in the law firm of Squire Sanders & Dempsey. In the year ended 5 April 2008, the year he claimed the deduction for the £215,455, Mr. Vaines was in professional practice as a partner in Squire Sanders & Dempsey and his share of profits from the firm represented his only source of professional income for the year. Mr. Vaines believed that the risk of challenging the German banks through the German courts was unacceptably high because if they were successful he would be made bankrupt. If he were made bankrupt, the Appellant would lose his position as a Partner in Squire Sanders & Dempsey.

The key to this decision is in Paragraph 3 when the FTT found as a fact that his purpose for making that payment was to preserve and his protect his professional career or trade.

HMRC were trying to disallow the payment on several grounds. HMRC argued that it was capital. They also argued that it was too remote from his professional activities as a solicitor in a London partnership because the litigation arose from his business in a different German legal practice. In addition HMRC argued that the expense was incurred to avoid personal bankruptcy and therefore not wholly and exclusively for the purposes of his profession.

This decision of the FTT is an interesting contrast to *Duckmanton v HMRC* [2013] UKUT which I reviewed in the AAT Tax Update 23 September 2013. Mr. Duckmanton had been denied a tax deduction for his considerable legal costs in defending himself against a gross negligence and manslaughter charge after one of his employees killed a pedestrian when driving a lorry.

Paragraph 29 states: "As Mr Vaines submits, in the present case no asset or enduring advantage was brought into existence by the payment he made to Bayerische Landesbank. Given our finding that this payment was to preserve and his protect his professional career or trade it must follow that it is a revenue and not capital payment and for the reasons above is deductible being incurred wholly and exclusively for the purposes of his trade."

The HMRC arguments failed and the FTT held that the sum paid by Mr. Vaines was allowable in computing his taxable profit. For tax purposes, any incidental benefit obtained by Mr. Vaines personally was to be ignored.

http://www.bailii.org/uk/cases/UKFTT/TC/2013/TC02965.html

4.4.3. Legal costs disallowed because of duality of purpose

In Philip McMahon v Revenue & Customs [2013] UKFTT 403, the issue was whether legal and associated costs of £115,354 were deductible under s34 ITOIA 2007 in the computation of profit.

On 8 August 2007Mr.McMahon signed a Tomlin order which compromised proceedings brought against him by Quantica plc. He had formerly been employed by Quantica plc in Quantica Search and Selection. He was a recruitment consultant with Quantica from 2003 and employed by Quantica until April 2007 by which stage he was Quantica's top performing manager.

In or about April 2007 the appellant decided to leave Quantica in order to set up his own recruitment business, working from home.

The terms of the schedule to the Tomlin orderwere that Mr. McMahon agreed to pay Quantica £100,000 in full and final settlement of all claims brought against him and of all claims arising out of his previous employment. The order was made on the basis that there would be no order as to costs. The appellant had incurred legal costs of £15,354.70 in connection with the proceedings.

HMRC contend that the sum paid by Mr. McMahon was at least partly referable to the his breach of contract. As such there was a duality of purpose and it was not incurred wholly and exclusively for the purposes of the trade. Mr McMahon contends that the payment was made for the sole purpose of preserving his business and should be deductible. Expenditure for the purpose of preserving a trade from destruction can properly be treated as being expended wholly and exclusively for the purposes of the trade.

The FTT found as a fact that the matters in dispute were plainly connected to the operation of the appellant's business. However they were also concerned with his employment contract. In particular the sum of £100,000 was calculated by reference to the sums earned by the appellant from the former clients of Quantica being Knauf, Eagle Ottawa, Thompson Plastics and Linpac. The payment of £100,000 and the legal costs incurred by the appellant had two purposes. One to preserve the business which, on its own, would have been wholly and exclusively for the purposes of the trade. The other to defend and settle the proceedings including the claim for damages for breach of contract and breach of fiduciary duty. Those claims arose out of the appellant's contract of employment. That duality of purpose was fatal to the claim to deduct the expense and the whole sum of £115,354 was not allowable for tax purposes.

This may seem unfair especially as Quantica will have been taxed on the damages it received yet the payer is denied a deduction. The UK tax system is often unfair and this case illustrates that in tax the fine letter of the law must be respected.

http://www.bailii.org/uk/cases/UKFTT/TC/2013/TC02799.html

4.4.4. PGA subscriptions are not allowable for tax purposes

HMRC specifically accept that a professional membership fee or an annual subscription may be deducted if the subscription meets the conditions of ITEPA 2003, s. 343 or s. 344.

For relief to be due, two general conditions need to be met:

(1) the duties of the employment must involve the practice of the profession to which the fee relates; and

(2) the registration, certification, licensing or other matter in respect of which the fee is payable must be a condition (or one of alternative conditions) that have to be met if that profession is to be practised in the performance of those duties.

HMRC have the power to add other types of fee and the bodies that have been approved by the Board are listed in a publication ('List 3') available for viewing at

www.hmrc.gov.uk/list3.

In The Professional Golfers Association Ltd v The Commisioners for Revenue & Customs [2013] UKFTT 605, the PDA were appealing HMRC's decision to refuse approval for the association.

The PGA, based at the Belfry, has approximately 7,500 members. About 6,000 of them are based in the UK and Ireland, and about half of these perform a fairly traditional "Pro" role at a golf club or driving range. The remainder have a wide range of activities related to golf, from specialist golf retailing to course design, managing entire golf resorts or individual coaching. PGA members generally make their living from the business of golf, not from playing it competitively.

The PGA's predecessor association was given a cup by one Samuel Ryder in 1927, to be competed for on a biennial basis by teams of professional golfers from the USA and Great Britain. The biennial Ryder Cup was effectively moribund (it was won by the USA on 17 of the 19 competitions following the Second World War) until it was decided in 1979 to extend it into a USA versus Europe competition and the European team finally won the cup at the Belfry in 1985. Since then, the Ryder Cup has become a very successful international sporting event. The PGA is entitled to a 20% share of the profits from the Ryder cup and this gives it an income of about £1.6million annually. There is no prohibition on the distribution of assets by way of dividend or otherwise prior to a winding up.

There are extensive powers in the Regulations to discipline members, including the power to fine, suspend or expel them.

The PGA employs approximately 125 people and its accounts for the year ended 31 December 2010 showed total turnover (for the company alone) of £11,874,403 and a total cost of sales of £11,599,832. In addition, it had some investment activities which generated further profits of £155,000. It also showed a profit share from an associated undertaking (Ryder Cup Europe LLP) of £275,000 for the year. In its consolidated profit and loss account, the turnover and cost of sales figures were both approximately £170,000 more (reflecting the consolidation of a small subsidiary company PGA Golf Management Limited) but the "share of results of associates" was shown in the much greater sum of £1,668,000, all of which was attributable to the Ryder Cup (made up of £1,393,000 of "operating profit" and £275,000 of "distributions").

The current subscriptions are of the order of £375 per year. One of the basic entry requirements for PGA membership is to play with a handicap of no more than 4 (or 6 for ladies). The PGA organises regular tournaments for PGA Pros – either "Pro-only" tournaments (for PGA members only) or "Pro-am" tournaments (where a PGA member plays with three amateur players in a team, against other similar teams). It organises between 500 and 600 such tournaments per year, of which about 80% are "Pro-am". All these tournaments have entry fees and pay prize money (some provided by the Appellant and some by sponsors). In a "Pro-only" tournament, PGA professionals compete only amongst themselves. In a "Pro-am" tournament, they compete for a team prize with their three amateur team members but also separately for an individual professional prize. Whilst the prize money might form a useful supplement to a player's earnings, it would not really be possible to make a living by playing tournaments. Some of these tournaments (usually Pro-am ones) find it possible to attract a sponsor to assist with the costs and/or prize money (often some local business).

Section 344(2) sets out the list of what might be called "permitted objects":

> "(2) The objects are –
>
> (a) the advancement or dissemination of knowledge (whether generally or among persons belonging to the same or similar professions or occupying the same or similar positions),
>
> (b) the maintenance or improvement of standards of conduct and competence among the members of a profession,
>
> (c) the provision of indemnity or protection to members of a profession against claims in respect of liabilities incurred by them in the exercise of their profession."

The statutory condition requires the Appellant's activities to be "wholly or mainly directed" to these objects.

56% of the Appellant's expenditure is, according to its own analysis, directed to its "tournaments" activity. This means that it fails the wholly or mainly test and as a result cannot be given the approved status necessary for employees to obtain a tax deduction.

So it is bad news for golf pros but good news is there for AAT members because AAT is on list three and subscriptions to working AAT members are deductible for tax purposes.

http://www.bailii.org/uk/cases/UKFTT/TC/2013/TC02992.html

4.4.5. Whether legal costs of defending a criminal charge were allowable.

In Paul Duckmanton v HMRC **[2013] UKUT 0305** the upper tribunal considered whether legal costs incurred by Appellant in defending criminal charges were incurred wholly and exclusively for the purposes of his trade – 'purpose' and 'effect' of incurring expenditure distinguished – s74 ICTA 1988 and s 34 ITTIOA 2005.

In 2002, one of Mr. Duckmanton's trucks was involved in a fatal accident killing a pedestrian. The truck was driven by an employee but maintenance defects in the vehicle led to a criminal charge of gross negligence manslaughter and two trials in 2003 and 2004 for which Mr. Duckmanton incurred considerable legal costs

Mr Duckmanton was at the material time the owner of an unincorporated car transport business called "Car Trans". The firm's business included the transport of vehicles from Solihull to the docks at Southampton and he had a fleet of 18 transporters.

The fatal accident was primarily caused by driver error but the vehicles brakes were defective and Mr. Duckmanton pled guilty to perverting the course of justice and falsifying maintenance documents for the vehicle.

The legal costs total £268,672, and were claimed as deductions in the accounts of the business for the accounting periods ending 31 August 2003 (£48,752), 2004 (£55,929) and 2005 (£163,991) respectively. The First tier tribunal disallowed the expenditure because the legal fees are incurred with the object of firstly defending criminal charges, secondly preserving a business reputation and thirdly avoiding the possibility of a substantial damages claim so the expenditure cannot satisfy the wholly and exclusively test.

Mr Justice Henderson found that the FTT was entitled to conclude on the facts as it did. The expense was not allowable for tax purposes because there were personal benefits to be obtained when the expense was considered.

http://www.bailii.org/uk/cases/UKUT/TCC/2013/305.pdf

4.4.6 Was it a repair or was it capital when a road entrance was widened?

In Hopegar Properties Ltd v Revenue & Customs [2013] UKFTT 331, the issue was whether or not the amount of £240,992.60 was a repair (allowable) or capital expenditure. The expense relates to the main entrance road to an estate, which was built some 40 years previously. It was in need of repair and widening with the increase in traffic to the estate of heavier lorries, transporters and other vehicles, which was substantially in excess of the original weight expectations when the road was built.

In addition to the main road, the footpaths were beginning to break up. As a result of road damage, there was a risk to under-laid fibre optic cables belonging to British Telecom, and these had to be re-laid. The landlord felt that tenants should contribute to the repairs given the size and budget for the work. The tenants agreed and contribution payments were made over three instalments.

As a result of the road widening, there was attendant landscaping required. Trees had to be removed and fencing and railings installed to comply with local authority and safety requirements. The existing car park was re-sited, enlarged and repaired. The total works took approximately 15 weeks to complete. During that time, access to the estate was via a temporary access road, which was constructed for that purpose.

The Company is owned by the Mackley family. Its principal activity is buying, developing, managing and letting of land and buildings including the land and buildings on the Mackley Industrial Estate in West Sussex ("Industrial Estate" which had the entrance road widened). The estate has 67 rental units and comprises approximately 309,500 square feet. There is 1,130 metres of road. The total length of fibre optic cable on the whole estate is 285 metres and the total length of telephone cable is 2,100 metres. The length of diverted fibre optic and telephone cable was 143 metres.

The work to the main carriageway (£135,141) involved widening and repair. It was required because the road was old and breaking due to the impact of heavy lorries over a period of years. The expenditure on the road can be broken down to show money was spent on labour, plant and material (£73k) and road surfacing (£32k). There was additional expenditure to muck away (£18k), road planing or smoothing (£400), road markings (£1,950), landscaping (£6,000) and footpath resurfacing (£2,300).

The road has been widened in parts from 6 metres to 8.6 metres. Evidence was presented to show that the increase in the area of road was some 3% of the road network on the Industrial Estate. The road was originally constructed as a sub-base and more concrete over the top. The concrete was in the form of slabs and therefore lay in sections. This concrete was replaced with tarmac. In order to lay the tarmac, it was necessary to re-lay thicker sub-base for greater load bearing. It was decided that tarmac could be laid more easily and quickly since concrete required a 28 day setting period and this would facilitate an earlier completion of the work.

The expenditure must be either capital or revenue, it cannot be both. HMRC's approach may be understood if one accepts that expenditure on capital works may include an element of revenue expenditure. In such a case, as here, there will be a separation of the two types of expenditure.

The key to this decision is to be found at paragraph 74. *"The Tribunal finds that defective parts of the road were being repaired. The older material was dug up and replaced with a more modern equivalent which met current standards. It was a substantial repair but not if one starts with the entirety of 1,130 metres of road on the estate as a whole. The repaired part of the road is not meant to function separately; it is the access point for the estate and the other parts of the road network. By its nature it is not physically or functionally distinct; it is part of the aggregate of roads and access on the whole estate."*

Road building is not an exact science but the functionality of the main carriageway is very near the same as before the works. The Tribunal, on balance, can see no increased functionality of significance. The work was essentially to repair the road not to produce something entirely new. The overall effect of the work was to give the estate back a functional carriageway at the start of the road network. The new main carriageway laid as tarmac was better than the old but physically, commercially and functionally was very similar to what existed before. The expenditure was revenue and properly allowed as a deduction for corporation tax purposes.

An interesting part of this judgement relates to the creation of a temporary access road which was essential to allow access to the estate when the main access road was having the work done. The main carriageway temporary diversion costs is put at £23,226 which is comprised of tree stump removal (£825), muck away (£6,224), sub-bases (£2,433), temporary surfacing (£8,545), labour (£2,156), plant (£1,918 + £1,125 = £3,043). We know that expenditure which is incidental to revenue expenditure is revenue. The Appellant has deducted a proportionate part of the sub-base (£2,433) and a proportionate part of the temporary surfacing cost (£4,718) and they have accepted that these amounts should be treated as capital. The remaining amounts are revenue expenditure which is incidental to the expenditure on the main carriageway.

£31,469.54 was spent for the diversion of the BT cables and fibre optic and this can be broken down into component parts. The Tribunal accepts, like the road network, that the relevant asset was the cable network for the estate as a whole. The cable network did not operate in parts but rather was part of one whole.

The witness evidence presented suggests that the movement of the cable was necessary for the road repairs. To the extent that it was necessary for the widening of the road, then those costs would have to be treated as capital. The widening of the road expenditure has been accepted as capital. The moving of the asset from one location to another does not of itself create a new asset. The installation of new cabling was of such a minimal amount that it cannot be said that it created a new capital asset. A cable network must be seen as a whole over the whole estate and the part that has been repaired and/or replaced is *de minimis.* The expenditure therefore would be revenue and treated as a repair.

The costs of changing the car park and repairing the dilapidated footpaths could easily be analysed between what was an alteration and improvement (capital) and what was claimed as a repair. HMRC's argument that the car park needed to be examined as an entirety was rejected because functionally it did the same purpose and to the extent that part had been repaired that cost was allowable for tax purposes.

Dr Khan's lengthy judgement contains several good summaries of relevant case law and is worth a detailed read. It is persuasive authority and clarifies the watershed between allowable repairs and capital expenditure.

http://www.bailii.org/uk/cases/UKFTT/TC/2013/TC02734.html

4.4.6. Whether a company could deduct sponsorship payments

In Interfish Ltd v HMRC [2013] UKUT 336, the issue was whether sponsorship payments intended to improve fortunes of sports club and benefit the taxpayer's trade could be deducted in computing the company's trade.

Over the years 2003,2005 and 2006 Interfish paid 1.2 million to Plymouth Albion Rugby Football Club (Plymouth Albion) describing the payments as deductible items for advertising and marketing. Interfish is a fishing, fish processing, fish wholesaling (in the U.K. and internationally) and fish retailing business based in Plymouth. Interfish is both a major employer in Plymouth and a significant business in the south west of England.

In the relevant period Interfish had advertised its South West Seafoods brand on a perimeter hoarding and on players' shirts as did other local companies. It is in addition an agreed fact that Interfish's South West Seafoods logo has been on each page of the club's website. Interfish also used the club for business hospitality.

It was viewed as significant that Interfish lent money to the rugby club and its sponsorship might have made it easier for the company to obtain loan finance by creating local goodwill. Interfish was helped by the goodwill created but the judge at FTT found that : "Interfish's purpose in making the payments can best be stated as being to improve the financial position of the Club, in particular by enabling it to enhance its squad of players without incurring a deficit, in order that those

involved with the Club would thereby be induced to look favourably on Interfish in ways that would assist Interfish's trade. I find that improving the financial position of the Club in this way was a conscious purpose in the mind of Mr Colam (and therefore the company);"

Mr Colam controlled Interfish. The expenditure of Interfish had a mixed motive and failed the test that the sole purpose was for Interfish's trade. That duality of purpose was a finding of fact that the FTT was competent to make. At Paragraph 41 the upper tribunal records "It is a finding which was plainly open to the FTT to make on the evidence in the case."

The payments were not allowable for tax purposes. At paragraph 46 Justice Birss records: "improving Plymouth Albion's finances was not an unintended consequence of Interfish's payments, it was an intended consequence. Both purposes were in view and therefore the payments were not wholly and exclusively for the purposes of the taxpayer's trade."

http://www.bailii.org/uk/cases/UKUT/TCC/2013/336.html

4.4.7. Were a doctor's travel expenses between his office at home and various sites allowable?

In Dr Samad Samadian v HMRC [2014] UKUT 13, the issue was the question of the extent of the right to deduct travel expenses when computing the profits of a trade or profession. Dr Samadian is a consultant geriatrician who works in full time employment in the NHS at certain NHS hospitals (principally St Helier and Nelson hospitals in south London) and also maintains a private practice as a self-employed medical practitioner.

This is a common pattern of working for senior medical practitioners. It is in relation to Dr Samadian's income from his private practice that the question of deduction of travel expenses arises.

For his private practice, Dr Samadian maintains an office at his home (where he does work relevant to that practice) and sees patients at consulting rooms hired by him at two private hospitals, St Antony's in North Cheam and Parkside in Wimbledon. He also occasionally conducts home visits. He uses a car to travel between these locations and to and from the NHS hospitals where he is employed.

Dr Samadian claimed a deduction which HMRC disputed for travel incurred:

(a) travel between the NHS hospitals and the private hospitals,

(b) travel between home and the private hospitals and

(c) travel between the NHS hospitals and a patient's home for a home visit.

The FTT found, among other things, that Dr Samadian had a place of business, in the sense of a "generally fixed and predictable" place at which he performs work in his private practice, at each of St Antony's and Parkside. It also found that he had "a place of business at his home, where he carried out part of the professional work necessary to his overall professional practice as well as the majority of the administration work related to it" The FTT ruled that (a) & (b) above were not deductible but(c) was allowable for tax purposes.

Because of the nature of the field in which Dr. Samadian practises, it is often important for him to take a "collateral history" from others, such as the patient's carer, relatives, GP, social services and the like. This helps him to build up a full picture of the case to enable him to structure his treatment plan properly. He will generally obtain any collateral history while working from his office at home, where he also does any necessary research and considers test results before deciding on the treatment plan. He then prepares the plan, generally in the form of a letter to the patient's GP, identifying what is wrong with the patient and what he considers should be done. This work is all done at home, and generally takes longer than the initial patient consultation.

Dr. Samadian has a separate office at his home which is used wholly or mainly for conducting his private practice. He has a desk, a chair, a medical library, a filing cabinet (with his business and clinical records) and computer, as well as his medical equipment and prescription pads. Sadly, for Dr. Samadian, although it was accepted that his home was a place of business, it was not his base of business. There was an implicit dual purpose when he travelled from home to a place where he saw patients and that was fatal to his claim to deduct the expenses.

The Upper tribunal ruled "..In my judgment, the FTT's decision was correct in all its essentials and this appeal should be dismissed. The FTT correctly applied sensible and coherent categories for treating travel expenses as deductible or non-deductible. I also think the categories applied would attract broad public acceptance. Travel expenses are treated as deductible in relation to itinerant work (such as Dr Samadian's home visits to patients). Travel expenses for journeys between places of business for purely business' purposes are treated as deductible. Travel expenses for journeys between home (even where the home is used as place of business) and places of business are treated as non-deductible (other than in very exceptional circumstances of the kind discussed at paragraph [27] above). Travel expenses for journeys between a location which is not a place of business and a location which is a place of business are not deductible…"

If you have clients who are doctors with a mixture of private and NHS employment work, this decision is a must read.

http://www.bailii.org/uk/cases/UKUT/TCC/2014/13.html

4.5. HMRC's views of the tax implications of adopting FRS101 &102

Accounting standards - the UK tax implications of New UK GAAP

HMRC has published two papers to assist companies with the adoption of New UK GAAP. The papers provide an overview of the key accounting changes and tax considerations that arise for companies that transition from Current UK GAAP to FRS 101 and FRS 102.

- the paper entitled 'FRS 101 Overview Paper' provides an overview of the key accounting changes and the key tax considerations that arise for those companies that transition from current UK GAAP to FRS 101 FRS 101 Overview Paper (PDF 121K)

- the paper entitled 'FRS 102 Overview Paper' provides an overview of the key accounting changes and the key tax considerations that arise for those companies that transition from current UK GAAP to FRS 102 FRS 102 Overview Paper (PDF 129K)

The main section of the papers is split into two parts. Part A provides a comparison to the position under current UK GAAP and Part B provides a summary of the accounting and tax considerations that arise on transition.

4.6. Dividend Waivers held to be a settlement

HMRC brings itself into disrepute when it uses the settlements legislation to challenge family arrangements and income sharing. HMRC's interpretation of the law ignores the clear policy statements made by the then Chancellor, Norman Lamont MP, when he was introducing the legislation for independent taxation. However, one can appreciate that certain aggressive arrangements need to be challenged especially when dividend waivers are necessary because otherwise there would not be sufficient retained profits to cover the whole dividend.

In Donovan & McLaren v Revenue& Customs [2014] UKFTT 048 dividend waivers were held to be a settlement. Mr Donovan and Mr McLaren each faced discovery assessments for the three tax years ended April 2008,2009 and 2010 for tax of approximately £13,800. Immediately I see a figure of tax that low I am concerned that there is no equality at arms because the appellants are unlikely to able to fund a contentious appeal.

Prior to 2001, the two gentlemen owned each 50% but then each gave their spouse 10% of the shares. A key finding of fact made by the first tier tribunal was that the company only held sufficient reserves if the earlier years' waivers were taken into account. The FTT took the view that to view the figures by ignoring previous waivers was artificial and that the cumulative effect of the arrangements should not be ignored. In those circumstances the FTT found that there was a lack of sufficient distributable reserves within the company were it not for the Appellants waiving the dividends.

The dividend waivers were not something which would have occurred on any arms length basis. The simple plan was to make use of the spouses' unused basic rate band by gifting income from the higher rate husband to the basic rate wife. The necessary element of bounty was there to decide that this was a settlement and the tax planning failed.

HMRC will be pleased by this victory but it is a persuasive authority only and not legal precedent. Practitioners advising their clients to share income amongst family members should ensure that there are sufficient distributable profits to cover the whole dividend before any waiver is considered to retain some of the profits within the company as working capital.

http://www.financeandtaxtribunals.gov.uk/judgmentfiles/j7541/TC03188.pdf

Workshop Chapter 4

Question 1 Constructors Ltd made up its accounts for the 18 month period to 31 May 2014 during which it incurred expenditure on qualifying machinery of £500,000

Calculate what Annual Investment Allowance is potentially available to the company.

Q1 Answer:	**Period 1/12/2012 to 31/12/2012**	**(**1/12 x £25,000) =	£2,084
	Period 1/1/2013 to 31/03/2014	(15/12 x £250,000) =	£312,500
	Period 1/4/2014 to 31/5/2014	(2/12 x £500,000) =	£83,334
	Total		**£397918**

Question 2: Big firm lawyers LLP appointed 10 new partners last year. Each of the new partners will be required to contribute £25,000 to their capital account by the end of their third year as partners. The partnership provides that the new partners have a fixed entitlement to the first £75,000 of the firm's profits and an additional entitlement to 0.1% of the firm's profits. They have no voting rights until they have contributed their £25,000 capital contribution.

Based on past experience, the 0.1% of the profit is around £14,000. As higher rate taxpayers, it usually takes the full three years to accumulate net after tax the required capital contribution after which they are able to draw down on their capital accounts provided the balance does not drop below £25,000

Q2 Discuss whether these new partners are now deemed to be employees.

Chapter 5

Capital Tax Update

5.1 Annual Exemption Individuals do not have to pay capital gains tax (CGT) unless their chargeable gains (net of all allowable losses) for a tax year exceed the "annual exempt amount" (AEA) for the year. The AEA is not available to non-domiciled individuals who claim the remittance basis of taxation for the tax year. Personal representatives of deceased persons are entitled to the AEA for the tax year in which the individual dies and the following two tax years. Trustees of settled property are entitled to a fraction of the AEA for an individual. In most cases the fraction is one-half, but a smaller fraction applies in some cases. Trusts for the benefit of certain vulnerable individuals are entitled to the full AEA due to an individual.

In 2013/14, The AEA was £10,900 and Finance Bill 2014 proposes a rate for 2014/15 of £11,000 and for 2015/16 of £11,100. Inflation is much higher so this restriction is a tax raising increase

5.2 Extension of OMR relief at end The exemption from CGT for an individual's principal private residence (OMR) was previously 36 months and it is proposed to reduce to 18 months but with a specific extension if the house was that of an elderly person who is now residing in a residential care home in which case the 36 months remains.

I have heard one tax expert suggest that there is a planning point here. If an elderly relative should be living with a family member, the expert suggest that they should be transferred into a residential nursing home at the end of the 18 month period to obtain the extension. In theory one can see this works but in practice this is the tax tail wagging the dog.

HMRC have been successful in challenging a number of cases in which the taxpayer has elected for a property to be treated as an only or main residence. HMRC challenge has been on the basis that the quality of occupation has not been sufficient to establish that the owner occupied it as an OMR. The evidential disclosures at FTT have been interesting because HMRC have produced utility bills demonstrating that the property was unlikely to be occupied and lots of personal information.

4.2.1. Whether the sale of part of the garden was exempt from CGT

The difference between the agricultural value of land and land with planning permission granted is enormous. The latter could be 100 times more valuable than the former. In **Anne Dickinson** v Revenue & Customs [2013] UKFTT 653, part of a garden was sold to a connected development company and HMRC decided that the only or main residence exemption from CGT (s222TCGA1992 et seq) was not available making the considerable gain chargeable to CGT.

Mrs Dickinson lived and owned land and property at Holly Lodge, High Street, Swineshead Lincolnshire which had large garden grounds including a tennis court. In 2007 she sold part of the tennis court, comprising 0.16 hectares, to Ilex Developments Limited, a company of which she was a director, for the sum of £300,000. The land was sold for the development of four dwelling houses, payment of the consideration being deferred and payable by four equal instalments of £75,000 on completion of the sale of each dwelling house.

Planning permission had been obtained in 1989 and Mrs Dickinson had renewed the outline permission on her garden/tennis court every three years to keep it current. She decided to design and build the houses herself. So, with her husband and two friends who had knowledge of the building trade, she formed a company, "Ilex Developments Limited" to manage the project.

Mrs Dickenson's 2007-08 tax return was submitted on 14 November 2008. The return did not disclose the land sale. On the basis that Private Residence Relief was applicable under s222 TCGA 1992, no Capital Gain was declared. HMRC selected the case for enquiry and if Mrs Dickinson is not entitled to private residence relief the tax is £48,314.20 plus interest.

There had been difficulty in getting the local authority to adopt the access road and this led to delay before the development started. HMRC argued that this meant that the land had ceased to be part of the garden at the time it was actually sold as it was sold as earmarked for development.

There was a natural demarcation line formed by a hedge between the tennis court and the retained property. The conclusion is that Ilex entering onto the land and starting the works did not constitute a disposal of the land. The land therefore retained its character as "garden or grounds" within the meaning of s 222(1)(b) until the time of its disposal on 27 July 2007 when contracts were exchanged. Accordingly, the land was exempt from CGT and within the OMR conditions.

http://www.bailii.org/cgi-bin/markup.cgi?doc=/uk/cases/UKFTT/TC/2013/TC03037.html&query=Anne+and+Dickinson&method=boolean

5.3 HMRC challenges on allowable costs. I would have thought that allowable costs are well understood to include the cost of acquisition, any enhancement costs reflected in the asset at the time of disposal and incidental costs of acquisition and disposal. Modern life produces new concepts of assets and there are still disputes about this issue appearing before the courts. Two cases, apparently similar, produced different rulings from the tribunal. (compare and contrast 5.3.1. with 5.3.3.below)

5.3.1 Can a contingent cost be deducted in computing CGT?

Before examining the main issue in this case, it is interesting to note that the FTT decided the issues on an anonymous basis and the parties wished the hearing by the Upper Tribunal to be held in private. This was rejected by the Court. Lord Glennie ruled:

"So far as the protection of sensitive information was concerned, while this is always a concern of any court, it seemed to me to be unrealistic to think that disclosure of allegations about events back in 2000 could give rise to any issues of commercial sensitivity now, some 13 years later. Further, the fact that the parties to the Settlement Agreement had agreed that it should remain confidential cannot be allowed to prevail over the requirement for open justice. The circumstances in which the court will depart from that principle will be many and varied. Obvious examples are in cases involving children, in asylum cases where there is a genuine fear of danger to life, or where measures are required for the protection of genuinely sensitive information. That list is by no means exhaustive."

In HMRC v Morrison [2013] UKUT 0497 the major issue was whether a payment of £12 million made by Sir Fraser Morrison ("SFM") to settle an action arising out of representations made or allegedly made by him with respect to Morrison plc ("MPLC") in connection with an offer for the purchase of the company by Anglian Water plc (later renamed AWG Group Limited) ("AWG") was a "contingent liability in respect of a … representation made on a disposal by way of sale of [SFM's shares in MPLC]" within the meaning of section 49(1)(c) of the Taxation of Chargeable Gains Act 1992 ("the Act"), requiring an adjustment to be made in terms of section 49(2) thereof.

AWG acquired MPLC in September 2000. The price paid by AWG for the whole issued share capital of MPLC was approximately £263.3 million. As a result of accepting the Offer, SFM received consideration for his shares (in the form of a combination of AWG shares and AWG loan notes) with an approximate value of £33.4 million for his 8 million shares.

In 2002 AWG alleged that it had been induced by a number of allegedly false representations and misstatements to offer more for the company than it was worth. It sought damages of £132 million, which was said to be the difference between the price paid by AWG for the whole issued share capital of MPLC (on the basis that the representations made by SFM were true) and the actual value of MPLC at the date of acquisition, plus consequential losses.

AWG and MPLC undertook to release SFM and the other director and each of the persons listed in a Schedule thereto as "the Morrison Interests", including SFM's immediate family and related trusts, from any liability that he or they might have (and whether or not known about at the date thereof). Without accepting liability, SFM was required by clause 2.1 of the Settlement Agreement to pay the sum of £12 million to AWG. He incurred legal costs to this point of £5 million which he also sought to deduct for tax purposes.

HMRC refused a deduction for the £12million in the computation of the capital gains liability but the FTT allowed some of this cost in principle leaving it to the parties to agree how much but the legal costs were denied a deduction in the computation of the gain..

The fact was that SFM had made a representation on the disposal of the shares and incurred a liability in respect of that representation. As a result, the proceeds to him of his disposal of his shares were less than it expected. The transaction left him £12 million worse off than he would otherwise have been

There are numerous cases which confirm that capital gains tax is a tax which should follow commercial common sense and if that were the case, SFM should have won the appeal. But he lost because the £12million was not a contingent sum paid and arising from the disposal. The settlement was as a result of alleged misrepresentations which he made as chairman of the company and so the link to the disposal of the shares was too remote. Lord Glennie said in his judgement:

"The liability of SFM on representations made by him as chairman of MPLC in connection with AWG's purchase of its whole share capital is wholly distinct from the consideration received by him for his shares in MPLC. He received his price for his shares by virtue of his ownership of the shares. It was the same price per share as was received by any other shareholder.."

In other words, the HMRC were right to deny SFM a deduction for the £12million he had paid to settle the dispute. Almost adding insult to injury, it seems that the process of litigation that led to the settlement had incurred legal costs of a further £5million and Lord Glennie ruled that these were not allowable in the computation of the gain on which SFM had to pay tax.

Tax can be very unfair at times. It seems SFM has been taxed as if he received £33.4 million but after paying for the legal costs and settlement totalling £17million it will seem to SFM that his net proceeds were £16.4 Million. Of course he will also face the additional costs of this litigation making him even poorer.

http://www.bailii.org/uk/cases/UKUT/TCC/2013/497.html

5.3.2. **HMRC win CGT allowable cost case** In Boota Singh Chahal v Revenue & Customs [2013] UKFTT 373,the issue is whether the Mr. Chahal should be allowed to deduct as allowable expenditure the whole market value of Grove Lane as at November 1999 (£52,000), rather than the expenditure that he actually incurred in two stages in 1983 (£7,500) and 1999 (£26,427).

In his self-assessment tax return for the year 1999-2000, Mr. Chahal included entries which treated the November 1999 transaction as a disposal of his half share in the property for net proceeds of £25,574. This resulted in him reporting a taxable gain of £7,600 which, after the annual exempt amount, resulted in chargeable gains of £500. Mr. Chahal paid tax on this gain at the time. His return for 1999-2000 was not taken up for enquiry by HMRC and the time for making any amendments to it, or for claiming repayment of any tax overpaid, is now well past. In his 1999-2000 return, the Appellant noted in the "Additional Information" section that "Grove Lane was transferred into the name of BS Chahal only in Oct 99"

That raises the question of whether such a full disclosure would prevent HMRC from making a discovery and the simple short answer is that it did not. In reality, Mr Chahal did not dispose of his half share acquired in 1983. He retained the half share and added the other half to own the entirety. Any claim for error or mistake relief would be out of time.

Mr. Chahal sold Grove Lane on 19 June 2006 for £147,500. His method of calculation meant the tax was reduced by £4,006.40 in the Appellant's tax liability for the year 2006-07. The tribunal ruled that HMRC's calculation is technically correct and there is no basis for it being required to include an additional £26,000 of allowable expenditure that the Appellant did not in fact incur.

The fact that Mr. Chahal had reported and erroneously paid tax on a gain in 1999/2000 was irrelevant and had no application in the calculation of what was his allowable cost in the computation of the gain. In tax, there is no equity or fairness. The extra tax was due.

http://www.bailii.org/uk/cases/UKFTT/TC/2013/TC02772.html

5.3.3. CGT: enhancement expenditure clarified on cost of shares sold

Nearly 50 years after CGT was introduced, I'd have expected that all the issues on the qualifying cost which can be deducted from the consideration received would have been solved. But in Mr Julian Blackwell v Revenue & Customs [2014] UKFTT 103 this was the issue because HMRC sought to increase, by £2,662,510.80, a liability to capital gains tax declared by Mr. Blackwell. HMRC decided that that expenditure of £17.5m claimed by Mr Blackwell as a deduction from the consideration received on the disposal of shares was not allowable under section 38(1)(b) of The Taxation of Chargeable Gains Act 1992 (TCGA). HMRC argued that this money was paid to release Mr. Blackwell from a personal obligation and did not affect the shares.

Mr Blackwell owned shares in classes A, B and C in what had been a family business, Blackwell Publishing (Holdings) Limited (BP Holdings), and he held two subscriber shares. His holding in the A shares was over 25% of the total and so his vote was necessary to secure any special resolution of the company. In an agreement dated 28 April 2003 with Taylor and Francis (a firm which wanted to buy BP holdings), Mr Blackwell undertook to do or not to do certain things connected with his A shares in return for a payment of £1m.

In 2006 Mr. Blackwell was given information about an approach from a US firm, John Wiley & Sons Inc (Wiley), offering to take over BP Holdings for a very much higher sum than had been considered but rejected from Taylor and Francis in 2003. Mr Blackwell obtained permission from BP Holdings to give Taylor and Francis limited information about the new bid and Taylor and Francis offered to release him from their agreement in return for a payment of £25m which would then enable him to vote in favour of the necessary resolutions to enable the new bid to go ahead. In negotiations it was envisaged that £7.5m of the £25m would in fact be paid to Taylor and Francis by the shareholders of BP Holdings rather than by Mr Blackwell himself.

The 28 April 2003 agreement amounted to an impediment to Mr. Blackwell acting freely to vote as he would have wished when the Wiley bid came to his attention. So his payment of £17.5 million was made to enhance the value of his shareholding and the enhancement was reflected in the asset when it was sold in the takeover.

A share is an intangible asset rather than a real object and that conceptually it consists of the rights and obligations that attach to it and derives its value from those rights. The FTT held that the expenditure of £17.5 million was on the shares, that it was for the purpose of enhancing their value and that it was reflected in the state or nature of the shares, the last point being that it is more accurate to say it was their state than their nature. So Mr Blackwell won his appeal and he was allowed to deduct the expenditure he incurred.

http://www.bailii.org/uk/cases/UKFTT/TC/2014/TC03243.html

Chapter 6

6. VAT Update and recent developments

6.1 Registration threshold increased from 1 April 2014 from £79,000 to £81,000

Similarly deregistration increased from £77,000 to £79,000

The official statistics estimate the VAT tax gap for 2012/13 at £12.9bn or 11.4% of the yield. By international comparison, this is relatively low. Some 'experts' estimate the tax gap to be much higher.

6.2 With VAT at a standard rate of 20% and yield estimated to be just over £110bn, VAT is an important tax for Government and for business. It is a tax on the final consumer and is imposed by European law. In comparison to the other European member states, the UK rate is in the middle and we also have zero rating on essentials like foodstuffs.

Zero rating creates a risk area as does the registration threshold and HMRC has been active in trying to pursue the boundaries. HMRC has frecently announced a consultation on the zero rating currently available on cars provided to wheelchair users because it has been concerned (rightly probably) on this relief being abused.

We saw in Chapter 3 how taxation on company cars is becoming punitive and is generally increasing with each passing year. VAT fuel scale charges effective from 1 May 2014 (PDF 46K)

Businesses must use the new scales from the start of the next prescribed accounting period beginning on or after 1 May 2014. For the reasons set out in Chapter 3 unless the individual has an enormous private mileage, it will not be tax efficient to provide private fuel.

HMRC provide advice to disabled users on the zero rating of cars scheme at
http://www.hmrc.gov.uk/helpsheets/vat1615.pdf

HMRC may have opinions and the statistics from the FTT may seem like an impressive success rate but HMRC can get things wrong and when they do the results of their error can be dramatic.

6.2.1. Did meals produced by students of a catering college carry standard rated VAT ?

It seems obvious to me that students studying catering and entertainment will generate meals and forms of entertainment as part of their studies. HMRC did not agree and appealed a decision of the FTT in HMRC v Brockenhurst College [2014] UKUT 46 which had confirmed that catering and entertainment supplied to members of the public were exempt.

HMRC argued that VAT is a tax on the final consumer which in this case was the meals being sold at 80% of cost to the public. As the public was not being educated but were enjoying the catering and entertainment generated by the students as part of their course, HMRC argued that 20% VAT should be added to the cost of the meals consumed.

HMRC’s argument ignored the fact that the restaurant meals produced were being sold at less than cost. That is not a business like activity.

The Upper Tribunal delivered a decision of precedent confirming the FTT decision that supplies of catering and entertainment services to members of the public are exempt as supplies closely related to the provision of education – Sixth VAT Directive, Article 13A(1)(m); Principal VAT Directive, Article 132(1)(i) – VATA 1994, Sch 9, Group 6, Item 4.

The college made a a voluntary disclosure on 5 January 2010, which included a claim for repayment of output tax on the ground that the supplies (of restaurant food and entertainment generated by the students as part of their courses of study) were exempt. The voluntary disclosure related to other matters as well, and related to VAT periods 01/06 to 10/09. The output tax claim related to periods 04/06 to 10/09.

The FTT found that the catering and entertainment services were both integral to and essential to the main supply of education. The FTT held that the students benefited from those supplies, and that they were the true beneficiaries, even though the supplies themselves were made by the College to third parties. On that basis the FTT concluded that the supplies of catering and entertainment services were closely related to the supply of education and/or vocational training, and were thus exempt.

The principal supply being made was one of education and the product generated was ancillary to that supply. A supply of education made by an eligible body is exempt and the Upper tribunal confirmed that the supplies by the college were exempt from VAT.

If you have any clients who are eligible bodies and have been supplying catering or entertainment generated by students as part of their education, a protective claim to recover output tax wrongly paid should be considered. You can read the full judgement at:

http://www.bailii.org/uk/cases/UKUT/TCC/2014/46.html

6.2.2. Promotional schemes and VAT following Associated Newspaper Ltd

In Associated Newspapers Ltd v Revenue & Customs [2014] UKFTT 116, the issue considered was the VAT outcome of a promotional scheme adopted to increase readership by offering vouchers for retail outlets.

HMRC contended that Associated Newspapers should account for VAT (based on the cost of the vouchers) when it gave them away to readers and newsagents who participated in the marketing schemes.

The First-tier Tribunal has agreed with Associated Newspapers that no VAT was due on ‘retailer vouchers’ given away to readers of the Daily and Sunday Mail newspapers as part of a marketing campaign designed to increase the circulation of the papers.

A decision of the FTT is persuasive authority only. It is not legal precedent but this decision may have implications for a wide range of business promotion and staff motivation arrangements that involve the distribution of vouchers of this kind.
http://www.bailii.org/uk/cases/UKFTT/TC/2014/TC03256.html

6.2.3. VAT guidance for organisers of sports leagues and competitions in circumstances where pitches and league/competition management services are being supplied.

On 15 February 2014 HMRC announced a new policy following the decision of the FTT in the case of **Goals Soccer Centres plc**. This policy applies to all organisers of sports leagues and competitions in circumstances where pitches and league /competition management services are being supplied. HMRC published brief 08/14

Goals Soccer Centres plc owned a sports centre with a number of five-a-side football pitches. It organised and administered competitive football leagues and competitions and charged the teams that participated. The FTT found that there were two separate supplies being made:

- a supply of land (the pitches) which was exempt as the relevant conditions were met, and
- a supply of administration and management services which was standard rated.

Where a single price is charged to the customer, businesses will need to determine the value of the two different supplies to establish the correct amount of VAT due. Whatever method is adopted to do this, there must be sufficient documentary evidence kept to show how a business has arrived at a fair and reasonable apportionment.

http://www.hmrc.gov.uk/briefs/vat/brief0814.htm

6.3 VAT pitfals and examples to learn from others mistakes

6.3.1 VAT : a fine mess which could have been avoided-Chelham Ltd

In Chelham Ltd v Revenue & Customs [2013] UKFTT 418, a group of companies made a dreadful mess creating a VAT liability which could easily have been avoided and incurring penalties for their mistakes. Chelham leases a commercial property at 245-254 Cambridge Road, London ("the Property"). No VAT is charged on the supplies by Chelham to the tenant of the Property. In other words Chelham is making an exempt supply to the tenant of a right to occupy land. Chelham acquired the Property in about 1994.

Chelham transferred its clothing business trade to its 99.8% subsidiary Perrie Ltd in September 1999, The clothing business is registered for VAT. Perrie additionally carries out certain property management services for Chelham. These include arranging insurance, repairs and maintenance. Chelham paid a management fee of £106,000 in the year ending 31 March 2009 to Perrie. VAT was charged and paid by Perrie in relation to this fee and a repayment claim was made by Chelham asserting that the VAT was deductible by Chelham as input tax.

"Oh dear" I can hear you say, dear listener, "if Chelham only makes an exempt supply it cannot possibly recover input tax. But why oh why was this structure or arrangement created? If Perrie is a 99.8% subsidiary, why did they not make a group election so that no VAT arose on the inter group management fee?"

I fear that whoever advised (or failed to advise) is going to be sued for negligence and I really do not want to add to their misery by stating that this case illustrates the importance of getting tax right. The whole problem could easily have been avoided.

Chelham could have managed the property itself so no VAT would have been added on exempt items like insurance. Or as stated, they could have elected for group registration in which case Perrie need not have charged VAT. But what they did was create a right mess having Perrie account for VAT which Chelham then attempted to reclaim. This was just stupid but the mistake which left HMRC considerably better off did not prevent HMRC from seeking a penalty from Chelham for seeking to reclaim input tax which it need never have paid in the first place if it had made a group election.

The company's argument boiled down to it being unfair that the VAT was irrecoverable and it should be excused the VAT and the penalty by HMRC allowing a back dated group election. How naïve! Everyone knows thast in tax there is no equity or fairness. The law is applied strictly. Those who get it wrong must suffer the consequences. So input tax recovery was denied and a penalty of 3% was upheld by the tribunal.

The penalties imposed, which had been reduced to 3% (£426 for 12/06; £420 for 03/07; and £452 for 03/08 arose under the old penalty regime. The company should be thankful that it did not face the current regime found at Schedule 24 , FA 2007 because the penalties would have been at least 5 times larger and possibly as much as ten times (30%) for a failure to take reasonable care.

http://www.bailii.org/uk/cases/UKFTT/TC/2013/TC02812.html

6.3.2 VAT denied on new building at college charity

In Chelmsford College v Revenue & Customs [2013] UKFTT 400, the dispute arose on the construction of a new building which was connected by walkway to an adjacent building enabling (rarely used) disabled access and sharing a heating system.

The new building was on the site of some other buildings which had been demolished and was for the purposes of Art & Design students and teaching. The connections between the A&D Block and the main building are effected by means of an enclosed bridge at first floor level and a pathway immediately below it. The bridge is lit but not heated, and is partly open to the air in the form of gaps between its floor and its glass walls, and there are doors at each end of it; it is the only disabled access to the A&D Block, because that block has no lift and disabled persons need to use the lift in the main building and pass over the bridge in order to get to the A&D Block's first floor. Alterations to the main building had to be made to provide for this bridge connection. On the ground floor, the connection is via a short open air path underneath the bridge, by virtue of which users are partly sheltered from the weather.

The college is a charity, that the construction was for a relevant charitable purpose and that Note (17)(b) is satisfied. It is argued that the A&D Block looks like a separate building, with its different height of widows and sloping roof and the overhang and window grids to restrict sunlight making it quite clearly distinct; and the first floor bridge and the walkway underneath even slope slightly. The A&D Block is, moreover, faculty-specific with its larger than usual rooms and suitability for heavy equipment, so that the precise teaching features installed were envisaged in the block's design.

All the students and staff need for their work is to be found in the A&D Block, and the fact that they could use the main building facilities does not detract from their not in practice needing to do so. In particular, the absence of a formal eating place is irrelevant because the college is responsible only for teaching, and the eating facilities in the main building are optional.

The centre of administration, without which the A&D Block would not function, without which the teaching staff would not be employed, and without which the facilities which are available in the main building would not exist, is located in the main building. The heating system operated from the main building and disabled access meant that the building were connected. As a result, zero rating was denied because this was the construction and extension of an existing building.

http://www.bailii.org/uk/cases/UKFTT/TC/2013/TC02796.html

In tax, especially VAT, practitioners must anticipate the strict interpretation of the law. If the A&D building had not been joined by the walkway and if it had its own heating system, it would have benefited from zero rating.

6.3.3 Could a business providing teaching to a University be VAT exempt for those services?

In Finance & Business Training (FBT) Ltd v Revenue And Customs [2013] UKUT 594, the issue was whether FBT could ring fence training courses it ran in association with the University of Wales and treat them as exempt from VAT.

FBT is an institution based in Birmingham which provides certain educational services. Some of those services are provided in relation to courses taught to some of its students in accordance with arrangements which FBT has made with the University of Wales. FBT claimed exemption from VAT conferred by Item 1 of Group 6 in schedule 9 to the Value Added Tax Act 1994 ("VATA 1994").

In order to be able to rely on that exemption, FBT must establish that it is "an eligible body" in accordance with Note (1) to Group 6. FBT accepts that it is not a college or institution of the University of Wales in relation to the remainder of its activities.

Principal VAT Directive (Council Directive 2006/112/EC), the relevant provisions of which are in Articles 131, 132 and 133 gives exemption from VAT for certain services, in connection with certain forms of education, provided by certain bodies.

In defining “an eligible body” within Group 6 the language does not appear to permit one to hold that a body is an eligible body in relation to some of its activities and not an eligible body in relation to others of its activities. Thus, a body is either a school within Item (1)(a) or it is not. A body is either a university or it is not. It would seem therefore that one will have to determine whether a body is, or is not, a college or institution of a university.

Paragraph 38 concludes that: “FBT is not a college or institution of the University of Wales when one takes account of all of the circumstances, including all of its activities, then it is not within the definition of "an eligible body". It cannot in law be an eligible body and, at the same time, not an eligible body. If it is not an eligible body, it cannot claim exemption under Item 1 even on those occasions when it provides services which would be exempt services if they were provided by an eligible body.”

So FBT must charge VAT on the training courses it runs in conjunction with The University of Wales, Imposing an additional 20% of VAT will have considerable consequence on the cost of the courses to students.

http://www.bailii.org/uk/cases/UKUT/TCC/2013/594.html

6.3.4 Whether repayment supplement payable for a VAT credit claimed other than in a VAT return

In HMRC v Our Communications Limited [2013] UKUT 595, the dispute was over whether repayment supplement was payable in respect of a VAT credit claimed other than in a VAT return.

Repayment supplement arises under section 79 of the Value Added Tax Act 1994 and provides that if HMRC delay a repayment excessively (more than 30 days) they are required to pay 5% as a supplement. Our Communications submitted its VAT return for period 01/06 promptly on 3 February 2006 claiming repayment of a certain sum. By a letter dated 3 March 2006, Our Communications claimed repayment of a further £1,488,006.74 in relation to period 01/06.

HMRC attempted to disallow part of the claims for three returns which the company appealed and at a hearing on 19 December 2008 the VAT and Duties Tribunal allowed Our Communications’ appeal against that decision. On 4 March 2009 (more than 30 days after the Tribunal’s decision) HMRC paid Our Communications the input tax which it had been denied.

HMRC subsequently paid Our Communications repayment supplement in respect of the sums claimed in its returns, but refused to pay repayment supplement in respect of the £1,488,006.74 claimed in the letter of 3 March 2006.

Now if I pause at this point and ask :”What would be fair?” HMRC has had £1,488,006.74 since January 2006 and there is a process which stops repayment supplement if there is a dispute. But when the FTT gave its decision, HMRC should have made the repayment promptly. It failed to so do.

Repayment supplement has been described as a “spur to efficiency” of HMRC: see *Customs and Excise Commissioners v L. Rowland & Co (Retail) Ltd* [1992] STC 647 at 655 (Auld J). Repayment supplement was intended to be HMRC’s equivalent to the taxpayer surcharge.

Counsel for Our Communications accepted that, on different facts to the present case, it was possible to envisage anomalies in the operation of section 79, but submitted that that did not compel the conclusion that the section should be construed as HMRC contended. HMRC argue that, as a matter of necessary implication, section 79 only applies where the amount in question is shown as due on the requisite return or claim, which in the case of a claim for payment is the return for the prescribed accounting period concerned.

The fact that HMRC succeeded in such a specious argument shows just how much fiscal law interpretation has changed. Interpretation of the law used to follow the strict literal rule.

http://www.bailii.org/uk/cases/UKUT/TCC/2013/595.html

6.3.5. VAT default surcharge penalties will be strictly enforced

Penalties which are punitive may be civil penalties but they engage with the Human Rights Act and give protection to those accused of becoming liable. It also means that the penalty must be clearly understood by the wrongdoer and proportionate to the offence.

In Gielly Green v Revenue & Customs [2013] UKFTT 509, the company claimed to have a reasonable excuse for being late with the payment but a surcharge was calculated at 15% of the VAT due of £35,928.23 creating a liability to a default surcharge of £5,389.23. Now default surcharge starts with a notice (a surcharge liability notice (SLN)) but it takes five defaults (or more) before it rises to 15%. So this company has a poor compliance record and should be aware of the consequence of delay.

The company had a due date of 7 October, 2012 for electronic VAT Payments and Returns. The VAT Return was received electronically by HMRC on 27 September, 2012. The company paid their VAT by way of a BACS transaction which was received by HMRC on 8 October, 2012. As the payment was received after the due date (07 October 2012), the Surcharge was correctly imposed unless the company had a reasonable excuse or the surcharge was disproportionate.

The company claimed to have a reasonable excuse because it had made every effort to pay its VAT liability on time and the reason the payment was received three day later (after being instructed on 05 October 2012) by HMRC was due to a banking error beyond the Appellant's control. Enquiries have been made of HSBC to establish why the payment was not processed on 06 October, when it was instructed by the company to pay on 05 October but without success. The onus here lies with the company and its failure to provide evidence from the bank denies it the argument of a reasonable excuse.

But that leaves the issue of whether imposing a surcharge of £5389.23 (15%) is disproportionate. The tribunal does not really consider this although it is implicit in the decision that the tribunal thinks such a large penalty is proportionate. The company had a poor compliance history and had been in the VAT default surcharge regime for some time (at least 2 years). The proprietors of the company would have been aware of the deadline for payment and the consequences of late payment. As stated in VATA 1994 s71(1)(b) where reliance is placed on any other person to perform any task, neither the fact of that reliance, nor any dilatoriness or inaccuracy on the part of the person relied upon is a reasonable excuse. The company therefore cannot rely on any delay caused by the bank, unless it can also show that the delay was caused by events entirely outside its own control. The company failed to introduce any evidence or explanation.

Given that the VAT payment was made at or after normal banking hours by the director, the company cannot suggest it is blameless for the delay that occurred.

The company has therefore not shown a reasonable excuse for the late payment. It was held liable to pay the surcharge in full.

http://www.bailii.org/uk/cases/UKFTT/TC/2013/TC02898.html

6.3.6. Whether dental payment services were exempt or standard rated.

If you have dentists clients who use payment plan services, this is a must read.

In D P A S Ltd v Revenue & Customs [2013] UKFTT 676, the issue was whether the change in contractual arrangements meant that the services provided direct to the customers of dentists were now exempt. As dentists themselves are exempt for most of what they do, the imposition of VAT at 20% would have serious implications to the cost base of dentists using the service.

HMRC also argued that the change in the contractual arrangements were an abuse of law and that the Halifax principle applied.

From 1 January 2012, in addition to a standard rated supply of services to dentists ,DPAS also made a separate supply of services to their patients which was an exempt supply of "payment services" within Item 1 of Group 5, Schedule 9 to the Value Added Tax Act 1994 ("VATA") and Article 135(1)(d) of Directive 2006/112/EC (the "PVD") and not a *Halifax* type abusive practice.

There are two broad categories of dental plans available to dental patients. These are described in the literature produced by DPAS as "Capitation" and "Maintenance" plans.

A Capitation plan includes dental services designed to prevent oral health deterioration, eg examinations, hygienist appointments, and small X-rays, but extending to include certain restorative dental treatment procedures such as fillings, root canal treatment and in some cases crowns and bridgework. The monthly fee paid by a patient will depend on the range of services to be provided under the plan and the oral health of the patient at the time of enrolment. This would involve an in-depth examination by the dentist, who would assess the amount of time and treatment required, before a patient was accepted for a Capitation plan.

In contrast a Maintenance plan includes only those services designed to prevent oral health deterioration and excludes restorative dental treatment. Consequently the monthly fees for such plans are lower than those for Capitation plans and an examination is not necessary for a patient to be accepted on a Maintenance plan.

Although the agreement to obtain dental services under a plan is made between a dentist and patient with the price, including dental plan charges, being agreed between them, the role of DPAS is to manage the administration, finance and insurance aspects of these plans. It also provides advice to the dentist and his or her practice staff in respect of setting up the plan and produces marketing materials such as brochures, leaflets and posters, registration forms, correspondence/headed note-paper and plan membership cards branded in the dentist's name.

In addition DPAS gives dentists administrative and marketing training and support through its business development manager, practice consultants and customer service advisers.

The "standard pricing" adopted by DPAS for the overwhelming majority of its clients is calculated by a combination of a monthly standing charge of £366.66 and what is described as a "per-patient charge" both of which are paid together on a monthly basis by direct debit.

On 28 October 2010, the ECJ gave judgment in Case C-175/09 *Revenue and Customs Commissioners v Axa UK plc* ("*Axa*") [2010] STC 2825. This ruled that the services provided by Denplan were standard rated being debt collection services for the dentist. DPAS therefore restructured its underlying contractual arrangements with the intention that, in addition to its supplies to dentists, it would also make supplies directly to patients.

The letter and Acceptance Forms were sent to approximately 340,000 patients and over 80,000, approximately 30%, of these were returned to DPAS. DPAS also received over 3,000 telephone calls to a helpline established to deal with issues raised by the letters with 90% of these calls sought confirmation that the amount they were paying for the dental plan would not be increasing.

The First tier Tribunal (FTT) decided that by continuing with payment the 70% of customers who did not expressly confirm their agreement to the new contract terms, did in fact agree to them.

Unlike the Denplan contract, as the contract was directly with the dentist's customer (and therefore a service to the debtor before a debt was created, and not to the creditor) the FTT concluded DPAS' services were exempt supplies. As there was no policy prohibiting the offering of dental plan services to individual customers, the FTT could see no argument for applying the European Law 'abuse of rights' principles to the arrangements adopted.

Paragraph 87concludes: " that DPAS does, as a matter of economic and commercial reality, make a supply of services to the patient for consideration."

Paragraph 106 concludes: "the service supplied "as a matter of principle" constitutes a transaction concerning payments which is exempt under Article 135(1)(d) of the PVD and Item 1 of Group 5 Schedule 9 VATA."

In tax there is a common truism that "It ain't what you do but the way that you do it." This decision illustrates that truism and if you have dentist clients a newsletter informing them of this decision might ensure that the dentists arrange a patient health carte plan in the most tax efficient way. Saving VAT at 20% can make a considerable difference.

http://www.bailii.org/uk/cases/UKFTT/TC/2013/TC03058.html

6.3.7. Refurbishment of a dilapidated property was a supply of services for VAT

Khoshaba t/a Cinnamon Café v Revenue & Customs [2013] UKFTT 481 concerns whether preregistration expenditure could be recovered. The issue was whether the costs incurred in refurbishing and converting a property previously used as a hairdresser into a café were a supply of services or goods. If the supply was for services, the input VAT incurred was out of time but if it were goods it could be recovered.

Mrs. Khoshaba obtained a lease of premises which had previously been used as a hairdressers. She had the premises converted by her husband's building company in order to operate a café, which commenced trading on 4 June 2007. Initially it was not VAT registered.

HMRC investigated her business in July 2010 and decided that it ought to have been registered with effect from 1 October 2008. There has been no appeal against that decision.

The first VAT return covered the period from 1 October 2008 to 31 May 2011. In this return some £46,757 worth of input tax was reclaimed (against a declared liability to output tax of some £48,000). HMRC required the taxpayer to breakdown and justify this input tax reclaim.

The main issue in dispute was an invoice which included £22,050 in VAT from Lindfield Building Contractors Ltd, Mrs Khoshaba's husband's company. The invoice was dated 30 July 2007. This was more than six months before the effective date of registration but less than 3 years before that date. It was accepted that the effect of the Value Added Tax Regulations 1995 Regulation 111(2) was to permit a taxpayer to recover pre-registration input tax incurred on supplies to the business in the four years prior to registration in so far as they were supplies of goods but only six months in so far as they were supplies of services.

The conversion of the property took approximately 4 months to be completed after possession of the premises was given by the landlord. The first month was spent in planning, making estimates, doing surveys and appointing architects and surveyors. The physical work to the shop took about two and half months.

The work to the ground floor shop involved ripping out the hairdressing fixtures such as the sinks, removing load bearing walls and replacing them with structural beams, replacing and enlarging the existing toilet facilities (including the necessary drainage works), re-plumbing and re-wiring the entire premises.

Once this was work was done and made good, counters and units which were built to order by a joinery company were installed. Fridges were purchased and installed. New wood flooring was laid.

A new air conditioning system was sub-contracted, and the sub-contractors installed it. A canopy and shutters at the front were also commissioned by Lindfield and installed by the company which made them.

The tribunal concluded that a significant part of Lindfield's invoice represented the cost of goods and a significant part represented the cost of services. The first question is whether Lindfield made a single supply to the appellant or a number of supplies. In other words, did it supply the prefab goods separately to the works of refurbishment of the premises? The tribunal concluded that this was a single supply in the sense that the elements which comprised the supply were so closely linked that they objectively formed a single indivisible economic supply.

At paragraph 36, the tribunal went on to cinclude that the supply was the service of providing a refurbished shop; it was not a supply of goods (the pre-fab units) with incidental installation works. The claim to recover input VAT did not fulfil the requirements of Regulation 111(4) because the invoice was for services which were provided more than six months before the registration date and therefore HMRC were correct to refuse to exercise their discretion to allow the recovery of the pre-registration input tax on the Lindfield invoice.

There were other subsidiary issues to this case but in the context of a non compliant taxpayer whose failure to register at the right time will suffer penalties, the decision demonstrates that in tax the strict interpretation of the law can be expected. In a project similar to that of Mrs. Khoshaba, an intended trader registration might have enabled all of the input tax on the services obtained to be recovered.

http://www.bailii.org/uk/cases/UKFTT/TC/2013/TC02864.html

6.3.8. Could belly dancing tuition get VAT exemption?

In taxation, the skill of a practitioner is often being able to interpret the law rather than knowing everything. We all know that in VAT, the law regarding exemption is to be interpreted strictly. With VAT at 20% a mistaken belief that an exemption applies is likely to prove costly.

In Audrey Cheruvier t/a Fleur Estelle **Belly** Dance School v Revenue & Customs [2014] UKFTT 7, the issue was whether tuition in belly dancing could be within the exemption from VAT. Ms Cheruvier provides tuition and instruction in the art of belly dance to students who attend the classes she runs and believes, after taking professional advice, that the teaching is an exempt supply within the scope of Item 2 of Group 6 of Schedule 9 to the Value Added Tax Act 1994 ("VATA 1994"), being the supply of private tuition, in a subject ordinarily taught in a school or university, by an individual teacher acting independently of an employer. HMRC disagreed and compulsorily registered the Ms Cheruvier for VAT purposes with an effective date of 1 June 2009. Following that registration HMRC made an assessment on the Appellant of VAT in the sum of £52,921.

While dance is taught in schools and examined, the belly dance courses are significantly shorter, lack any written element of study, are not taught to any external syllabus or standard, and are not examined. The tribunal ruled that the private tuition given by the Appellant is not in a subject ordinarily taught in a school or university, and accordingly is not within the scope of the exemption conferred by Item 2 of Group 6 of Schedule 9 to VATA 1994. The Appellant is therefore making taxable supplies, and her appeal against HMRC's decision to this effect is dismissed.

The FTT conclusion is that she is engaged in providing recreation rather than education to those who attend the courses she runs. An activity which is recreational may be studied with as much diligence and care by those who wish to excel in it as an activity which is educational in its nature. Most forms of dance (ballroom **dancing**, Morris **dancing, belly dancing** , to identify three at random) are inherently recreational, that is, for the enjoyment and satisfaction of the participants (including their satisfaction through performance) rather than for their intellectual development in terms of expanding or deepening their knowledge. A form of dance may move from the recreational to the educational where it is studied in the context of its history, cultural background and relevance, artistic aspirations and achievements, and critical appraisal, but we had no evidence that the courses provided by the Appellant covered such matters. The courses are practical in nature - teaching individuals how to belly dance. They are not courses in the study of dance in an educational sense.

Ms Cheruvier faces a large VAT bill of £52,921 which she is unlikely to be able to recover from former students. It demonstrates how important it is to take care on these issues and to make sure in any case of doubt that a ruling is obtained from HMRC.

http://www.bailii.org/cgi-bin/markup.cgi?doc=/uk/cases/UKFTT/TC/2014/TC03148.html&query=Audrey+and+Cheruvier+and+Belly&method=boolean

6.3.9 Card game of Bridge is not a sport

With VAT at 20%, the difference between charging VAT and supplying something which is exempt is significant. The basic principle of interpreting whether an exemption might apply is to construe the law strictly. In this case, the interpretation or definition of what is a "sport" had to be decided.

The English Bridge Union (EBU) appealed to the First Tier Tribunal against HMRC's refusal to repay VAT on competition entry fees it raised between 30 June 2008 and 31 December 2011. HMRC argued that under the Euroepan VAT directive and UK law, contract bridge was not a sport. Consequently, the entry fees were properly standard rated.

I was surprised at the evidence produced by the EBU which included correspondence to the tribunal from French, Dutch, Belgian, Irish and Polish bridge bodies explaining that VAT was not charged on entry fees in their countries. TheEBU's barrister pointed out that bridge was recognised as a sport by the Olympic Committee.

Contract bridge is a trick playing card game played by four players in two competing partnerships with partners sitting opposite each other around a table. The game has four phases: dealing the cards, bidding, playing the cards, and scoring the results. Millions of people worldwide play bridge in clubs, tournaments, online and with friends.

The EBU is a non profit making body whose objects are to regulate and develop duplicate bridge in England. Its members are counties, clubs and individuals. Playing bridge involves the use of high level mental skills: logic, lateral thinking, planning, memory, sequencing and others. Playing bridge regularly promotes both mental and physical health and studies have shown that it may benefit the immune system and reduce the chance of developing of Alzheimer's disease and of mental deterioration.

"Sport", argued HMRC, is something in which physical skill is essential to success. The definition in the Oxford English Dictionary:

> "an activity involving physical exertion and skill in which an individual or team competes against another or others for enjoyment",

and that adopted by the Council for Europe in its Sports Charter:

" 'Sport' means all forms of physical activity which, though casual or organised participation, aim at expressing or improving physical fitness and mental well being, forming social relationships or obtaining results in competition at all levels."

Charles Hellier, the FTT judge ruled that the normal English meaning of "sport" requires:

(1) the application of some significant element of physical activity;

(2) that such physical activity is itself an aim, or that it will have a direct effect on the outcome of the activity; and

(3) that physical skill – of which mental skill may be a part, and which includes physical endurance – is important to the outcome.

To the FTT sport normally connotes a game with an athletic element rather than simply a game. The FTT ruled that the competition fees were VATable and HMRC were right to refuse the claim for repayment.

http://www.bailii.org/uk/cases/UKFTT/TC/2014/TC03321.html

6.4 Forthcoming developments

Mandatory electronic filing was held to be a violation of Human Rights. HMRC have issued a consultation proposing to publicise and introduce an option of telephone filing of VAT returns but in some ways that consultation illustrates that HMRC have serious flaws in their judgement. What tjhey propose will be more expensive and less reliable than a return to paper filing for those that wish to use this method. In fairness to HMRC their consultation does recognise that their policty of mandatory electronic filing and payment was abusive but surely we should expect HMRC not to make mistakes like this?

6.4.1. FTT decides that mandatory electronic filing and payment is unreasonable

In what is a test case for many people, Barbara Mosedale judged at the FTT, that electronic filing may be a breach of human rights and the way that HMRC had imposed it was unreasonable. In LH Bishop Electrical Co Ltd A F Sheldon (t/a Aztec Distributors) v Revenue & Customs [2013] UKFTT 522, the lawfulness of HMRC's requirement that they file VAT returns on-line and, in one appeal, the obligation to make payments electronically was challenged

Approximately 100 taxpayers have filed appeals against notices to file online, mostly in VAT cases but also in PAYE cases. The joint appellants' case is that HMRC acted in breach of its public law duties in failing to exercise a discretion which the regulations gave them.

This is a very lengthy decision because first the tribunal had to decide it had jurisdiction to hear the cases. It did. Then it had to decide whether HMRC's decision to refuse other methods of filing and payment was reasonable. Personally, I think that HMRC's decision to pursue these exceptions lacked common sense but what HMRC was doing was applying a law that Parliament had enacted. Our tax law is badly written and produces all sorts of unintended consequences and this is an example of HMRC applying bad law but doing so in order to achieve economies and staff reductions.

In this joint appeal, several of the appellants had severe disabilities and did not have convenient access to computers. HMRC's response to this was that the appellants could ask friends and family for help and also they could use HMRC's telephone service. The first means a loss of independence and the second was at the time a dreadful service often with HMRC not answering the phones despite the caller letting it ring for considerable periods. That loss of independence and loss of privacy is a breach of Human rights.

The tribunal criticised the HMRC research on internet filing and payment for failing to take account of persons who might have difficulties in filing online due to old age, computer illiteracy, disability or lack of reliable internet access.

There is a great deal of analysis in this judgement and consideration of the individual circumstances and evidence. It takes determination and perseverance to read this decision but by pargraph 510 it concludes on the telephone filing concession: "..it is unlawful to act as HMRC have done and give a concession but fail to publish it. It is a fundamental principle that HMRC should treat taxpayers equally. They cannot do this if the concession is unpublished and in effect only communicated to those who happened to be the lead appellants in the litigation or those who phoned a helpline. In this HMRC have acted as no reasonable taxing authority could have acted."

Even worse the judgement criticises HMRC which ought to have considered the relative costs to HMRC of paper and telephone filing. The evidence strongly suggests that telephone filing costs HMRC (in HMRC officer time) more than paper filing and it is only viable because so few people are offered it.

The possible methods of compliance discussed at the hearing were as follows:

> (a) The taxpayer could use his own computer and internet link. For taxpayers without an online computer this would involve capital expenditure on the purchase of hardware and software and income expenditure on a monthly contract for broadband or dial-up link to the internet The FTT Found "If the appellant did not own an online computer, compelling the taxpayer to buy one in order to file its VAT return would in my view be a breach of A1P1 as it would be an interference with the possessions of the taxpayer beyond the margin of appreciation allowed to governments because it would be out of all proportion to the cost benefit to HMRC and discriminatory against persons who were old as they are less likely to know how to use a computer and therefore to own one; in any event it would also be a breach of A1P1 combined with A14 for the same reason.;
>
> (b)The taxpayer could use an online computer belonging to a friend or family member assuming that friend or family member gave permission. This would not be expected to involve expenditure on the part of the taxpayer. This is a breach of privacy and Article 8
>
> (c) The taxpayer could use a public computer free of charge at a public library. The discrimination is against elderly persons, and those who live remotely. This is because by reason of old age, an elderly person is less likely to own a computer. They are therefore the persons who would be obliged to use a public library to file. This therefore is discrimination against elderly persons. The regulations fail to accord to elderly persons the same right to confidentiality that younger, computer owning and computer literate persons are given by the Government. This is a breach of A8 combined with A14.
>
> (d)The taxpayer could engage a professional agent to make the online submission on behalf of the taxpayer. This is a breach of A1P1 alone or in conjunction with A14 because of its discriminatory nature in so far as it applies to those who are computer illiterate due to their age, persons who are too disabled to use a computer reliably or without pain, and those who live remotely
>
> (e) At the request of the taxpayer, a friend or family member could make the online return submission on behalf of the taxpayer. This fails article 8
>
> (f) The taxpayer could use HMRC's "phone filing" facility. The judge mentions this option but she have already determined that HMRC cannot rely on it in these proceedings, so it is irrelevant as an option.
>
> (g) The taxpayer could use free of charge a dedicated stand-alone computer at an HMRC enquiry centre but the judge have already determined that HMRC cannot rely on this option in these proceedings, (because HMRC have already announced the closure of enquiry centres), so it is irrelevant as an option.

The judgement made findings of fact on the savings to HMRC (see § 375) and the costs to the appellants (§ 378). In summary the cost saving to HMRC appears to be less than £8 per return (ie less than £32 per year). The cost to the appellants who don't have a computer of buying an online computer is many multiples higher than this (£200-£400 per year). The FTT ruled that it was satisfied that this would be an excessive burden on those individuals (§ 603). But, as there were other means available such as taxpayers could comply by employing an agent at an annual cost of about £60 or more per annum – (see §383) which is significantly less the burden is within the margin of appreciation available to the state.

The judgement finds that mandatory filing and payment causes indirect discrimination against old persons, who because of their age were computer illiterate, and against disabled persons, who due to their disability were unable to use a computer or only able to use one with difficulty. There was also discrimination against those who lived in too remote an area for broadband access.

While the regulations can be justified, the failure to make exemptions for these three classes of persons cannot be justified for the reasons given.

This is a 933 paragraph judgement and it deals with some very complex arguments examining the extent of administrative law and the interaction of tax law and human rights. It is a must read for all practitioners.

http://www.bailii.org/uk/cases/UKFTT/TC/2013/TC02910.html

6.4.2 HMRC published new guidance on VAT for refunds from manufacturers

Under EU law the net amount of VAT collected by HMRC on a supply to a final consumer cannot be greater (nor less) than that due on the total amount paid by the final consumer. If the final consumer receives a refund or reimbursement of the purchase price, then the total amount paid by him or her will be reduced and the VAT previously accounted for must be adjusted accordingly.

The European Court of Justice in the case of Elida Gibbs (C-317/94) held that a manufacturer was entitled to adjust its VAT to take account of reimbursements paid directly to final consumers under a promotion scheme. The same principle applies when a manufacturer makes a refund direct to a final consumer but in the past HMRC wrongly refused to entertain such claims.

HMRC now accept that refund payments of this type can in some cases represent reductions in the consideration received by the manufacturer.

The Government has therefore introduced a new Regulation 38ZA which expressly provides for adjustments in both Elida Gibbs reimbursement and dissatisfied customer refund scenarios. Manufacturers may therefore be entitled to seek recovery of VAT not already adjusted in past periods subject to the normal capping rules of 4 years.

The new Regulation takes effect from 1 April 2014 and covers any refund (as defined in that regulation) made in a VAT period that ends on or after that date. The term refund includes a cash payment in respect of damaged or faulty goods and a cash reimbursement paid under a promotion scheme (such as “cash back” deals or money off vouchers). In either case, the payment must represent a reduction in the consideration for the final supply of the goods.

The following are examples of where manufacturers are able to adjust their VAT:

- payments in relation to "money back" promotions;
- payments for faulty products;
- payments for damaged products; payments made where the customer is generally dissatisfied with a product rather than being able to demonstrate a fault or damage; and
- payments made in connection with product recalls for safety, health or quality issues

You can read more about the detail by following VAT Information Sheet 03/14 . This information sheet explains HMRC's policy on the application of the new regulation. If you have clients affected by this change in policy and practice I recommend making protective claims to HMRC as soon as possible because the 4 year time limit is likely to be strictly enforced.

6.5. Composite Supplies

Identifying the major component in a composite supply can have very significant consequences, especially a mistake is made. With the standard rate of VAT at 20% the commercial advantage of being able to apply a zero rate or an exemption can be considerable.

VAT is a tax on transactions, so the VAT treatment of a supply can only be decided by analysing the transaction.

A composite or multiple supply is a single supply with more than one component. The UK has reduced rates the most widely known being zero rating which is available on supplies defined within Schedule 8 of VATA 1994. VAT is charged at one rate on all the consideration which is determined by identifying what is the major component of the what is supplied . For example, if a newspaper which is zero rated gives its buyers a free music CD, the major component which determines the nature of the supply is the zero rated newspaper. By way of contrast, if a CD was accompanied by a booklet which commented on the CD, all would be standard rated at 20% because the principal supply is that of the CD and its electronic music content.

Different components may have mixed liabilities to VAT if supplied separately. The different components may be a mixture of goods and services. If a separate charge is made for part of the supply, this does not necessarily mean that there is a multiple supply. Supplies should not artificially be split nor should they be artificially combined if they are really independent.

6.5.1 Composite supplies and why it matters

A multiple supply (also known as a combined or composite supply) involves the supply of a number of goods or services. The supplies may or may not be liable to the same VAT rate. If one of the component supplies had a zero rate and the other had a standard rate, there might be a commercial advantage to try to treat the major element of the supply as the zero rated item. Individual examples need to be considered on an individual basis and as a result few of the decisions in this complex area of VAT practice establish precedent decisions.

Probably the leading case is that of Card Protection Plan Ltd v C & E Commrs [1994] BVC 20 in which at p. 28, Balcombe LJ in the Court of Appeal said that whether an element is an integral part of an overall supply ‘is necessarily a question of impression on which different minds may reach different conclusions’.

Travel on public transport like a train is zero rated (Schedule 8, VATA 1994). If a train business provides zero-rated travel from London to Edinburgh, it need not declare a proportion of output tax on its receipts if the journey includes a cup of coffee which is supplied separately would be standard rated. The complementary cup of coffee provided to all passengers ancillary to the travel, which is what the customer paid for. The cup of coffee (or tea) serves no other purpose than to make travelling more comfortable: i.e. it is incidental to the main supply. The same result would apply if the ticket price included a complementary meal and drink because the major component which the rail traveler is buying is the zero rated element of transport between Edinburgh and London.

If the journey is on the train, say the Flying Scotsman steam engine, from Edinburgh to Birmingham and includes a five-course meal with wine and champagne, the customer probably receives two supplies: (1) zero-rated travel and (2) standard-rated catering and output tax at 20% needs to be accounted for on this catering element requiring an apportionment of the total price paid.

If a supply is seen as insignificant or incidental to the main supply, then for the purposes of VAT it is usually ignored – the liability is fixed by the VAT rate applicable to the main supply (or supplies).

A case which clarifies the principles of identifying and dealing with VAT is Tumble Tots (UK) Ltd v R & C Commrs [2007] BVC 179. Members of a playgroup received a T-shirt (children's clothing is potentially zero rated) and a magazine (potentially zero rated) as well as the right to attend classes which would be standard rated. The Court decided that there was a single standard rated supply of the right to belong to the playgroup and the T shirt and magazine were incidental to that main supply. No one who was not in the playgroup would have bought the T shirt or magazine separately. The principles which emerge from the cases are:

(1) the identification of the taxable supply or supplies made as a particular transaction is, at least where it is under a contract, limited to the goods and or services provided in return for the payment;

(2) prima facie every supply of a good or of a service must normally be regarded as distinct and independent;

(3) nonetheless the functioning of the VAT system would be distorted if what is in substance a single service from an economic point of view was artificially split;

(4) the relevant transaction must be analysed with due regard to all the circumstances in which it takes place. Over-zealous dissection and analysis of particular clauses should be avoided;

(5) the essential features of the relevant transaction must be ascertained in order to determine whether the taxable person is supplying the customer with several distinct principal services or with a single one;

(6) that the goods and/or services are supplied in consideration of a single price may suggest that, for VAT purposes, there is a single supply, but this is not decisive;

(7) where elements of the consideration are ancillary to another element or elements identified as the principal service, there is a single VAT supply of the principal service of which the ancillary elements will be treated as part. A service will be regarded as ancillary to a principal service if it does not constitute for customers an aim in itself, but is a means of better enjoying the principal service supplied.

If we expand a little on item (3) above, the courts have had to consider cases which involved artificial splitting as well as cases where there was artificial mixing of supplies. There is a single supply where one or more elements are seen to provide the principal service, and the others are regarded as ancillary. A service must be regarded as ancillary to the main service if it does not constitute for customers an aim in itself, but is a means of better enjoying the principal service.

There is a truism in tax that in many cases it ain't what you do it's the way that you do it that can arrange a tax advantage. In BSkyB the company tried to apportion the subscription price between a standard rated supply of TV entertainment and a zero rated listings magazine. They failed because it was a single composite supply and the magazine was incidental to the TV entertainment subscription. But in Telewest Communications plc v C & E Commrs [2005] BVC 156 the arrangement gained by separating the zero-rated magazine from a standard-rated supply of TV services. It did this by having a separate company provide the magazine. Although the operating companies supplying the TV service collected the magazine subscriptions on behalf of that separate company, the Court of Appeal held there to be two supplies and the House of Lords refused to hear an appeal from HMRC.

Any exemption from VAT must be strictly interpreted and applied. Those supplies which benefit from exemption are defined in Schedule 9 VATA 1994 and include education. But if the trader is exempt, that trader cannot recover input tax that it incurs. If that trader does incur input tax, for example on the construction of a building or even the repair of a lecture theatre, the input tax is effectively an additional cost. Education may involve lectures, practical work and self study reading books and notes which the education course provider supplies. On the latter items there was uncertainty which was removed by Finance Act 2012 which makes it clear that the provider of education cannot apportion the consideration paid by students between zero rated but taxable notes and the exempt supply of education. In *College of Estate Management v C & E Commrs [2005] BVC 704*, the college lost its contention that part of the student fees should be treated as a zero rated supplies of written material.

Ten years ago, many shops started to claim that they would charge say 2.5% of the consideration received as an exempt supply of card processing services. This was challenged quickly by the then Customs and Excise (now HMRC after the merger of Customs and Excise with the Inland Revenue in 2005). Attempts to treat as included in the retail price of positive-rated goods an exempt fee for handling a credit card have failed Debenhams Retail plc v C & E Commrs [2004] BVC 554.

In Bookit Ltd v R & C Commrs [2006] BVC 605 the company Bookit Ltd was a member of the Odeon Cinema group with its own VAT registration. It handled sales of cinema tickets on Odeon's behalf by telephone or via the Internet. Bookit:

(1) gave the customer information about film times, ratings and seat availability. The tribunal decided that it did this as agent for Odeon;

(2) agreed to sell the tickets. Again, this was as agent for Odeon;

(3) took the customer's credit card details, which it transmitted to Girobank for clearance. Here, the tribunal saw Bookit providing a service to the customer; and

(4) informed Odeon of the tickets sold. This was, again, something Bookit did for Odeon as its agent.

A booking fee per ticket was charged, the dispute was whether it was a supply of standard-rated ticket-selling services (which are VATable) or, as Bookit successfully maintained, of exempt financial services.

The Court of Appeal held that the services supplied by Bookit to cinema-goers, in return for the sum above the ticket price were exempt card handling services within VATA 1994, Sch. 9, Grp. 5, item 5 as interpreted in accordance with Note (5). HMRC have accepted this judgment (Business Brief 18/2006 (30 October 2006); Notice 701/49).

Because VAT is a transaction based tax, it is essential that traders get it right when the transaction occurs. Mistakes, especially if HMRC believe that the mistake has arisen from a failure to take reasonable care, potentially could incur penalties under Schedule 24, FA 2007. But in practice a knowledge of the principles can enable a trader to obtain a commercial advantage. A trader might save VAT by combining a standard-rated supply in a car with the principal supply of zero-rated transport. In Virgin Atlantic Airways Ltd v C & E Commrs [1995] BVC 93, there was a single zero-rated supply of an airplane ticket supplied with a standard-rated chauffeur-driven limousine for the journey between the airport and the passenger's initial point of departure such as his house to the airport.

British airways faced a challenge on its complementary supply of catering during flights but it was successful in arguing that the price paid was for zero rated transport and the catering was incidental.

This remains a difficult are in practice and potential mistakes are embarrassing and potentially might place the trader within the penalty regime. In cases of doubt, I recommend approaching the National Advice service (NAS) to seek a ruling. Over the years, my experience of dealing with the NAS has been extremely variable. Sometimes the service has been excellent but at others they just refer the enquirer to a leaflet and do not answer the question. In composite supplies they often refer to VAT Information Sheet 2/2001 which is entitled 'Single or multiple supplies – how to decide'.

The advantage of seeking a ruling is that it demonstrates that the trader has taken reasonable care. If at some future point a visiting officer from HMRC decides that your treatment was incorrect, the VAT position may need to change from that point onwards. However, so long as your view prior to that point was tenable and you can demonstrate that reasonable care was taken, the penalty regime will not apply and changes will be prospective but not retrospective.

In Rowe & Maw (a firm) v C & E Commrs (1975) 1 BVC 51 , a solicitor's rail and air travelling costs were separately itemised as disbursements on the bill sent to the client but that did not make them zero-rated. They were expenses of the solicitor, not separate supplies to the client. It was unsuccessfully contended that such costs were zero-rated. By way of contrast, a disbursement made by a solicitor acting as agent of the client such as the payment of stamp duty when the client bought a house would be outside the scope for the client who is the end user.

In C & E Commrs v Plantiflor Ltd [2002] BVC 572, Plantiflor sold plants by mail order. Customers could collect the plants, in which case no delivery charge arose. Alternatively, Plantiflor arranged delivery via Parcelforce and a charge was made for post and packing – the £1.63 which Parcelforce billed for delivery. Plantiflor's contract with Parcelforce specified that Plantiflor acted as agent for the customers.

Analysing the supply, that contract with Parcelforce was a red herring because Plantifor made a single standard rated supply of bulbs and delivery. They had to account for VAT on the consideration received for delivery.

In United Biscuits (UK) Ltd (t/a Simmers) v C & E Commrs [1992] BVC 54, the court held that the supply of biscuits in a tin was a single zero-rated supply of biscuits, the tin being merely the packaging.

Morrisons lose VAT challenge on portable BBQs: In W M Morrison Supermarkets PLC v HMRC [2013] UKUT 247, the issue was whether there was a single standard rated (20%) supply of a disposable BBQ kit or whether the charcoal fuel element could be separately charged at its reduced rate of 5%. It might be tempting to think the difference is trivial but to the large supermarket chain the VAT difference was £192,934.51. If Morrisons could charge separately for the charcoal, it could reduce the price and make it more marketable, possibly gaining a competitive advantage in the marketplace. Asda and Tesco had similar appeals on the same issue.
On 19th October 2006, HMRC issued Business Brief 17/06 clarifying that, according to HMRC, the correct treatment of sales of disposable barbecues was as a single standard rated supply. Factually these disposable BBQs comprised at least 50% of the value as fuel which could be sold separately and benefited from charcoal being subject to the reduced rate of VAT pursuant to Group 1 of Schedule 7A to the Value Added Tax Act 1994 ("VATA 1994").

The First Tier Tribunal (FTT) upheld HMRC's contention that a disposable BBQ was a single supply that fell to be standard rated. The judgement contains an interesting review of decisions on composite supplies and is worth a read at:

http://www.bailii.org/uk/cases/UKUT/TCC/2013/247.html

Cases sited in this part of the VAT Update lecture that are useful in arguing to support a contention on composite supplies.

Card Protection Plan Ltd v C & E Commrs [1994] BVC 20
C & E Commrs v Plantiflor Ltd [2002] BVC 572
College of Estate Management v C & E Commrs [2005] BVC 704
Debenhams Retail plc v C & E Commrs [2004] BVC 554
Rowe & Maw (a firm) v C & E Commrs (1975) 1 BVC 51
Telewest Communications plc v C & E Commrs [2005] BVC 156
Tumble Tots (UK) Ltd v R & C Commrs [2007] BVC 179
United Biscuits (UK) Ltd (t/a Simmers) v C & E Commrs [1992] BVC 54
Virgin Atlantic Airways Ltd v C & E Commrs [1995] BVC 93

6.6 HMRC challenge areas

6.6.1 Input VAT RecoveriesHMRC are required to apply the law as an enacted by Parliament. In the case of *Alex Paton & Son v R & C Commissioners [2009] UKFTT 79,* the issue was whether a farmer was entitled to claim input tax on the purchase of a Land Rover Discovery which was used wholly and exclusively for the purposes of the farming business. This particular issue has been considered frequently by the courts. The law tests, in relation to whether or not a business is able to recover the input VAT on the purchase of a vehicle, whether or not that vehicle is available for personal use. Cases which have tested this include:

C & D Commissioners v Upton t/a Fagomatic [2002] BVC 451 - Mr Upton was successful supplying and servicing cigarette vending machines in the clubs. His justification for the business using a Lamborghini Diablo was that turnover increased by 50% because club doormen viewed him as a person of consequence. The input VAT was £19,572. Though the taxpayer claimed never to use the vehicle privately, it was available for his private use and insured as such. Accordingly, the courts ruled that there was no evidence or material to support a conclusion that the taxpayer did not intend at some point in time to make the car available to himself for private use. The input VAT was therefore not recoverable.

In *Revenue & Customs Commissioners v Shaw [2007] BVC 854,* the taxpayer was a farmer and contracting business. He bought a 4 x 4 vehicle with a petrol engine for personal use and a 4 x 4 diesel for business. The diesel car was parked on the business premises but was insured for personal and social use as well as business use. His claim to recover the input tax was denied because he had taken no positive steps to prevent the vehicle from being available for his personal use. An intention to use the vehicle exclusively for business purpose did not exclude the possibility of the vehicle being available for personal use. It is almost impossible for a sole trader to make a contract with himself that would preclude him using it privately. It is therefore necessary for there to be a prohibition such as no insurance coverage.

6.6.2. Advise or not? In *Customs & Excise Commissioners v Elm Milk Ltd [2006] BVC 296*, the court ruled that the company was entitled to recover input tax incurred on the acquisition of a car which was to be used for business purposes only. Mr P was the sole director of the company. The car was normally parked near the taxpayer's office and adjacent to his home. The keys were kept in the office and insurance cover included private use by P and others. However Mr P had placed an embargo in private use by drawing up a contract between himself. This was a resolution of the Board and the court accepted that a genuine contractual stipulation against private use meant that the car was not available for private use by whatever means.

Returning to the *Paton* case, Mr Paton was senior partner in a farm but was partially disabled due to osteoarthritis and he had had a hip replacement and both knees were problematic. He bought a New Generation Land Rover Discovery paying extra for air suspension which allows the body of the vehicle to be raised and lowered. The vehicle had off road tyres and Mr Paton intended to use it exclusively for the purposes of the farming business. He claimed £4,575 as input tax in respect of this vehicle.

Ever since the Inner House of the Court of Session decision in *Customs & Excise Commissioners v Skellet [2004] SC 351* which ruled that a vehicle would be available for private use unless effective steps were taken to render the vehicle incapable of private use, informed practitioners know that HMRC will pursue a denial of the input VAT on purchase of a vehicle.

When HMRC were giving training sessions on the implications of the new penalty regime to be found in schedule 24 Finance Act 2007, a claim to recover input tax on a vehicle which was available for private use was viewed as a failure to take reasonable care. This meant that a maximum penalty of 30% could be charged and if it was discovered after an enquiry had begun it would be a prompted disclosure with a minimum penalty of 15%.

The fact that HMRC used such an example is worrying. Again there appears to be an almost Alice in Wonderland policy as to how HMRC apply tax law. Mistakes in what would appear to be a complex area of the law now face possible penalties. Is arranging for a prohibition by contract or arranging for insurance to exclude any private use tax avoidance and if so is it acceptable? My worry, irrespective of the answer to this last question, is that a failure to arrange a prohibition of use may mean that the tax adviser was held to be negligent in his duty of care. That could mean the adviser is sued for damages.

If a client hopes to recover input tax on a vehicle, it is essential to show that reasonable care has been taken in deciding the input tax recovery position. Good advice would be to follow the courts guidance and render the vehicle not available for private use. This could be done by an insurance exclusion or by a contractual arrangement provided there are legal persons with which to contract and to record the prohibition of any private use.

6.6.3 Input tax recovery Generally, VAT is only reclaimable if it is charged on a supply to the claimant (VATA 1994, s. 24(1)) and the expense has been incurred with a view to making taxable supplies.

Care is needed when deciding to whom and for what fees have been incurred. The risk areas are too many to mention but I am going to select a couple of the more common difficult areas.. We have just looked at cars.

Input tax is defined as VAT incurred on goods or services which are used or to be used for the purposes of the business (VATA 1994, s. 24(1) and Directive 2006/112, art. 168). Thus, VAT incurred on expenditure which is not for the purposes of the business is not input tax and is not recoverable.

Whether goods or services are obtained for the purposes of the businesses is sometimes open to doubt. In determining whether input tax is recoverable, it is not sufficient that the business has funded the expenditure; it must also have been incurred for the purpose of the business and the making of taxable supplies.

There is no comprehensive definition of "*business purpose"* because of the wide variety of circumstances in which businesses operate.

The question of "*business purpose*" was considered in *Ian Flockton Developments Ltd v C & E Commrs (1987) 3 BVC 23*. The company manufactured mouldings and plastic storage tanks. A racehorse was purchased in order to promote the company's image and to provide a talking point during discussions with potential customers.

The company was successful in recovering the input VAT. In the judgement which is often cited, Stuart-Smith J stated at p. 28:

> *"The test is, were the goods or services which were supplied to the taxpayer used or to be used for the purpose of any business carried on by him? The test is a subjective one: that is to say, the fact-finding Tribunal must look into the taxpayer's mind as it was at the relevant time to discover his object. Where the taxpayer is a company, the relevant mind or minds are those of the person or persons who control the company or are entitled to and do act for the company.*
>
> *In a case such as this, where there is no obvious and clear association between the company's business and the expenditure concerned, the tribunal should approach any assertion that it is for the company's business with circumspection and care, and must bear in mind that it is for the applicant to establish its case and the Tribunal should not simply accept the word of the witness, however respectable. It is both permissible and essential to test such evidence against the standards and thinking of the ordinary businessman in the position of the applicant. If they consider that no ordinary businessman would have incurred such an expenditure for business purposes that may be grounds for rejecting the applicant's evidence, but they must not substitute that as the test. It is only a guide or factor to take into account when considering the credibility of the witness, and no doubt there will be many other factors which bear upon that question which the Tribunal should well understand.*
>
> *The Tribunal must look at all the circumstances of the case and draw such inferences as they think fit. In the end it is a question of fact for them whether they were satisfied on the balance of probability that the object in the taxpayer's mind at the time the expenditure was incurred was that the goods and services in question were to be used for the purposes of the business".*

In *Chain Telecommunications Ltd v Revenue & Customs [2012] UKFTT 330*, the company paid the invoices for legal services which had been supplied to a predecessor company which had been acquired.
This is an interesting area of VAT law and one that needs to be monitored because Supreme Court decisions are expected later in 2012 and in early 2013. The application of the judgment of the ECJ in *Revenue and Customs Commissioners v Loyalty Management UK Ltd; Baxi Group Ltd v Revenue and Customs Commissioners* [2010] STC 2651 was due to be considered by the Supreme Court in October 2012. Further, the approach set out in Redrow was to be the subject of argument in *WHA*, which was to be heard by the Supreme Court in January 2013.

It is widely accepted that in Redrow, the court posed four questions for a person claiming to deduct input VAT, namely:

(i) Did that person instruct the supplier to do something?
(ii) Was something done for or obtained by that person?
(iii) Did that person use that something in the course of [sic] furtherance of its business?
(iv) Did that person pay consideration for the something which included VAT?

In this case, the company might have paid the bill but it failed the other three tests. It was a predecessor business that it acquired out of administration that instructed and received the legal advice. That legal advice did not relate to the making of taxable supplies in the payer's business.

Thus the answer to the question, under s 24(1)(a) VATA 1994 (whether the services were supplied to Chain) is that they were not. Failure of that precondition means that the VAT paid by Chain as part of its payment of the invoices does not constitute input tax.

Three different legal firms had been involved but the VAT of £7,706 could not be recovered. In tax, the letter of the law has to be interpreted and in this case the economic cost of 'doing the right thing' includes the VAT which is irrecoverable: http://www.bailii.org/uk/cases/UKFTT/TC/2012/TC02016.html

6.7 Whose tax is it and who has to pay? VAT on cars for the disabled

I had a feeling of déjà vu as I read the case of *Dennis George Bunning and Christina Denise Bunning t/a Stafford Land Rover v Revenue & Customs [2012] UKFTT 32*.

It may be just a coincidence but it reminded me of the decision in *Croall Bryson*. In the *Croall Bryson* case, I remembered that one of the purchasers of a vehicle which had been adapted for use by a handicapped wheelchair user was a Mr K Myles who, from memory, bought a 4 x 4 Land Rover and sold it within a week.

With VAT at 20%, there is an economic driver for someone to take advantage of the zero rating which is available under group 12, item 2A, schedule 8 VATA 1994 which provide that a qualifying motor vehicle can benefit from zero rating if it is sold to a handicapped person who usually uses a wheelchair. To qualify for zero rating the vehicle must be adapted to enable the disabled wheelchair user to enter, drive or otherwise travel in the vehicle and it must be used for domestic or personal use and the vendor must retain documents to show the eligibility of the vehicle and its purchaser.

The original assessment was in the amount of £48,457 plus interest of £5,423 but after an internal review by an officer of HMRC the amount assessed was reduced to £13,839. This was the quantity for the disputed sale of a Range Rover Sport HSE and a Land Rover Discovery.

An important question here is to ask who is the abuser? The Land Rover dealer has to accept on trust that the purchaser who is demonstrably disabled is not abusing the zero rated provision by acquiring a zero rated Land Rover and then on selling it. In fact a person acquiring an asset with a view to selling it at a profit is trading and would be required to report the taxable income from the transaction.

It is good practice for the vendor to hold copies of documents showing that the conditions for zero rating have been supplied but actually this is not a statutory requirement.

The Tribunal ruled that the handicaps of Mr Myles and Mr Randall were such that they qualified. They were handicapped persons who usually used their wheelchair for mobility.

The Land Rover and Range Rover were both qualifying motor vehicles.

The worry arising here is that HMRC are tackling those with the deepest pockets and are rightly concerned that zero rating of vehicles could be abused by handicapped people. The issue is surely whose tax is it? Is it just a coincidence that in 2 different published tax decisions the buyer of a vehicle which benefitted from zero rating was a Mr K Myles?

A sad consequence of this action is noted at paragraph 45 of the decision when Mr Bunning added that:

> *"Because of the difficulty he had experienced with the supplies which are the subject of this appeal, the Appellant was now very reluctant to sell cars to disabled persons and that he has in consequence been accused of discriminating against such customers".*

HMRC are concerned that the zero rating for such vehicles is being abused. A newsletter to clients setting out the condition might be good customer care.

http://www.bailii.org/uk/cases/UKFTT/TC/2012/TC01730.html

Recently HMRC announced an intention to consult on the zero rating of cars for disabled wheelchair users. Again if you have clients in the car sales business a newsletter might be helpful;l alerting them that change may be on the horizon and in the meantime to be thorough in documentary support that the buyer of a zero rated vehicle qualifies.

6.8 VAT and aggregation of businesses

With the standard rate of VAT now at 20%, persons, especially those selling to the general public, sometimes try to split a business into parts, so that one part or more than one part makes supplies which are under the registration threshold. If this works, a lower price might be charged than that charged by VAT-registered competitors. Alternatively, the same price might be charged, but usually the profit will be greater than that made by the VAT-registered competitors.

Splitting a business is especially profitable where the main inputs are not VATable, such as accommodation, wages or food. Hairdressers and Launderettes are potential abusers of fragmentation schemes in which persons have formed several companies to trade from a single property or different chairs, with each company trading on a different day and keeping below the registration threshold.

John Smith trading on his own account is a different legal "*person*" from John Smith trading in partnership with his wife. Equally, if John Smith trades on his own account and his wife also trades on her own account, they trade in partnership and they have a separate limited company John and Mabel Smith Ltd, there are four different legal entities trading and all might stay under the VAT registration threshold currently of £81,000 pa.

HMRC can make a direction to deem the persons named in it ('the constituent members') as being one person (a 'single taxable person') for VAT purposes, and so registrable from the date of the direction (VATA 1994, Sch. 1, para. 2). Such an original direction cannot be made retrospectively. HMRC can make the direction if they are satisfied that:

1. each named person makes taxable supplies;

2. the activities in the course of which the supplies are made form only part of a business described in the direction, the other activities of that business being carried on concurrently or previously (or both) by the other persons named in the direction; and

3. when all the activities of the business are considered together the person carrying it on is liable to be VAT-registered.

HMRC no longer need to be satisfied that "*the main reason or one of the main reasons*" for splitting the business activities is to avoid the need for one (or more) of the named persons to be VAT-registered. Whether it is reasonable to issue a direction will really be a matter of judgement dependent on the facts in individual cases. But if there is a strong interdependence between the allegedly separate activities and common records and bank accounts, the probability of a direction increases. Conversely, different persons conducting businesses that are entirely unrelated need not lose sleep about this anti-avoidance provision.

In *A D and J Forster v Revenue & Customs [2011] UKFTT 469*, the issue was whether a bed and breakfast business conducted by the farmer's wife at Parsonage farm should be aggregated with the registered farming business conducted in partnership by the husband, wife and son.

Parsonage Farm has been owned by the Forster family since 1936. The farm comprises 150 hectares and is wholly arable. Mrs Foster, aged 67, plays no active part in the farming activity which is mainly done by the son who lives in a house in the nearby village. Mr and Mrs Forster moved into the farmhouse in 1971. Mrs Forster started the B & B in 1975 as she wanted to earn some money working from home independently from the farm.

The annual turnover of the B & B for the last five or six years has been approximately £6000 to £8000. The farming partnership and the B & B maintain separate books of account. Mrs Forster has her own bank account, which she uses for the B & B business. The B&B covers the costs of window cleaning, laundry and maintenance of the AGA in the farmhouse and also a gardener over the summer months.

The farmhouse is on two floors. On the first floor are four bedrooms (one of which has an en-suite bathroom) and a "*family*" bathroom. One of the bedrooms is used by Mr and Mrs Forster, and the other three are used for the B & B. When they are not in use for the B & B, the bedrooms are used by Mr and Mrs Forster's personal guests (such as their grandchildren). On the ground floor is a dining room (which is used by the B & B to serve breakfasts – when not in use for the B & B, it is used privately by Mr and Mrs Forster), a sitting room (used privately), a kitchen/conservatory (used privately as well as for preparing breakfasts for the B&B), a sewing room (used privately) and a "*summer*" room (used privately). There are also a back kitchen and pantry. The farmhouse forms part of the farm's assets and there is an adjustment to disallow private use of overheads – a key finding of fact because it meant that the partnership was not meeting the cost of the farmhouse.

HMRC contend that the farm and the B & B are not sufficiently at arm's length from each other, and that they do not have a normal commercial relationship with each other – and that the reality is that there is one business – being the business of farming activities *and* the bed and breakfast. Without the farm, the B&B would not be a viable business.

There was no evidence that the farmhouse was used by the farming business – indeed the evidence was that the farm was now run from the son John's home and the Finn cabin which contained the office. HMRC did not take into consideration the fact that the B & B business had been started by Mrs Forster in the 1975, when her parents-in-law were the main partners in the farm. The B & B had been started by Mrs Forster independently of the farming business for entirely legitimate and understandable reasons.

The B & B is not closely bound to the farming business by financial, economic or organisational links. The FTT decided that the HMRC officer could not reasonably have concluded that it was appropriate to make a direction. These were separate businesses and so the appeal against the direction was allowed.

My thought process is to question how this case ever came to the Tribunal. Surely there is someone within HMRC who has an iota of common sense? The officer had little justification for his position and his line manager should have stopped this. Having made the error, the taxpayer's appeal should have succeeded at the internal review stage. The fact that this case appeared before a tribunal is worrying because it indicates that HMRC internal review procedure is not working properly.

What is worse is the pettiness of the HMRC contention and arguments. Even taking the higher figure of turnover of £8,000 the issue is about £1,333 of potential VAT. The cost of the appeal will be more expensive than the VAT at issue. The decision is worth a read even if only to identify the parties who demonstrably lacked judgement.

http://www.bailii.org/uk/cases/UKFTT/TC/2011/TC01319.html

HMRC would probably justify their challenging farmhouses by reference to a similar case which was decided differently. In Howard Rowland Patrick And Jennifer Rosemary Patrick v Revenue & Customs [2011] UKFTT 865, East Hook Farm in Pembrokeshire is run as a partnership by Mr Howard Patrick with his wife, Mrs Jennifer Patrick. The business, which is VAT registered, includes the traditional farming activities of beef and sheep production as well as a haulage operation and the provision of self-catering accommodation in an outbuilding that has been converted into a holiday cottage.

Mrs Patrick was a sole trader with turnover of £61,000 offering a B&B accommodation. The faremhouse is used to accommodate B&B guests with two additional rooms, in the same building as the self-catering cottage, used for those guests unable to use stairs or requiring disabled access.

Schedule 1 of the Value Added Tax Act 1994 provides:

> *1A(1) Paragraph 2 below is for the purpose of preventing the maintenance or creation of any artificial separation of business activities carried on by two or more persons from resulting in an avoidance of VAT*
>
> *(2) In determining for the purposes of sub-paragraph (1) above whether any separation of business activities is artificial, regard shall be had to the extent to*

which the different persons carrying on those activities are closely bound to one another by financial, economic and organisational links.

2(1) Without prejudice to paragraph 1 above, if the Commissioners make a direction under this paragraph, the persons named in the direction shall be treated as a single taxable person carrying on the activities of a business described in the direction and that taxable person shall be liable to be registered under this Schedule with effect from the date of the direction or, if the direction so provides, from such later date as may be specified therein.

(2) The Commissioners shall not make a direction under this paragraph naming any person unless they are satisfied—

(a) that he is making or has made taxable supplies; and

(b) that the activities in the course of which he makes or made those taxable supplies form only part of certain activities, the other activities being carried on concurrently or previously (or both) by one or more other persons; and

(c) that, if all the taxable supplies the business described in the direction were taken into account, a person carrying on that business would at the time of the direction be liable to be registered by virtue of paragraph 1 above;

HMRC issued a direction after establishing the facts as follows:

(1) The bank accounts for the farm partnership and B&B are both joint accounts in the name of H & J Patrick although the B&B account is "T/A East Hook B&B".

(2) Putting the holiday cottage into the partnership keeps the B&B below the VAT registration limit.

(3) Although separate records are kept, the same bookkeeper is employed for both businesses.

(4) Money is sometimes transferred from the B&B bank account to the farm account to ease cash flow and is then transferred back (Mr Harrison did however accept when asked by the Tribunal that he would not necessarily expect to see formal arrangements in place where, as in this case, the parties concerned were husband and wife and that he had taken this into account when considering whether a direction was appropriate).

(5) The self-catering cottage and B&B were included on the same website where they are presented as one business.

(6) Although advertised in separate sections of the *Farm Stay* website and brochure they appear to a potential customer to be part of the same business.

(7) The same building (a converted outbuilding) is used for both B&B and self-catering.

(8) There is a combined insurance policy in the names of both partners which specifically mentions the B&B.

(9) The farm/haulage business is loss making and would not be viable without the holiday business.

(10) The properties are all owned jointly by Mr and Mrs Patrick and there are no charges for rent or for the use of fixtures and fittings by Mrs Patrick (However, when giving evidence Mrs Patrick told us that she did pay rent to the farm partnership for the use by the B&B of the two rooms which are in the same outbuilding as the self-catering cottage).

(11) The purchase of the farm and refurbishment of the farmhouse to make it suitable for B&B was financed by mortgages in the joint names of Mr and Mrs Patrick together with the proceeds of sale of their previous property.

(12) Mrs Patrick deals with all the bookings for the B&B and self-catering.

(13) The same invoice book is used for the B&B and self-catering.

In a way, this case is an illustration of how not to separate a business. However, having regard to financial, economic and organisational links closely binding the B&B and farm, particularly the self-catering cottage, there was an artificial separation of business activities which resulted in the avoidance of VAT. For this reason it was reasonable for HMRC to issue the direction that Mr and Mrs Patrick be registered for VAT as a single taxable person with effect from 22 February 2010. Note that the direction is prospective and not retrospective.

Workshop VAT

Question 1 A company acquired new Robinson R-44 Helicopter which had the company's logo printed on its side. The Helicopter was hangered at the farm where (directors f the company) lived; this saved on hanger charges that would be incurred if a commercial airfield was used. This helicopter was sold in 2010 and VAT charged on the sale.

The directors and their son flew the helicopter but when they flew privately they paid a commercial and arms length rate to hire the helicopter from the company. Accordingly, the company had recovered the input tax on the purchase of the helicopter. In addition to the directors flying the helicopter, it was hired to a pilot flying instructor at the commercial rate of £150 an hour and this was a rate comparable to helicopter hire with other businesses providing a similar hire facility. The directors paid the same rate when they flew in a private capacity.

HMRC raised and assessment on the company denying the full recovery of the input tax . An analysis of usage suggested to HMRC that the helicopter had been bought for mainly private usage because less than 25% of the flying time related to the company's parts business. This led HMRC to assess £39,246 and to seek to impose an interest charge of over £5,200 on the company for overclaiming input VAT.

During the period in dispute the 2007 Helicopter logged 54.3 flying hours. These may be summarised as follows and are examined further below:

Use of 2007 Helicopter	**Flying hours**
Parts Business	13.2
Maintenance	19.2
Hire to Mr Mark Greenway	10.0
Hire to Mr Nick Tolley (son)	4.8
Hire to Mr Keith Tolley(director)	7.1
Total	**54.3**

Discuss whether you agree or disagree with HMRC

Q1 Answer This is a real case

1. **Input VAT tax on a helicopter used for business and flown by director**

In JNK 2000 Ltd v Revenue & Customs [2013] UKFTT 221 (TC), the issue was whether the input VAT on purchase and maintenance of a helicopter could be recovered in full when there was private use by directors.

HMRC assessed VAT in the amount of £39,246 (plus interest of £5,288.37) alleging that the company had overclaimed input VAT is several accounting periods. The business is mainly the design, development, manufacture and distribution of specialist parts for 4X4 vehicles, especially Land Rovers ("the Parts Business"). The Taxpayer part-exchanged its previous helicopter which the director flew for a new Robinson R-44 ("the 2007 Helicopter").

The Taxpayer's corporate logo was painted on one side of the 2007 Helicopter. The 2007 Helicopter was hangered at the farm where Mr & Mrs Tolley (directors f the company) lived; this saved on hanger charges that would be incurred if a commercial airfield was used. This helicopter was sold in 2010 and VAT charged on the sale.

The facts were that during the period in dispute the Helicopter logged 54.3 flying hours. These may be summarised as follows and are examined further below:

Use of 2007 Helicopter	**Flying hours**
Parts Business	13.2
Maintenance	19.2
Hire to Mr Mark Greenway	10.0
Hire to Mr Nick Tolley (son)	4.8
Hire to Mr Keith Tolley(director)	7.1
Total	**54.3**

Use in the Parts Business included visits to owners of Land Rover vehicles for measurement and fitting of new designs; visits to customers requiring urgent deliveries; visits to customers for photo-shoots, and other marketing opportunities.

A hire fee was charged to Mr Greenway , an unconnected helicopter pilot instructor. Mr Tolley set the hire fee by reference to what was charged by other suppliers such as Heli Air. In the period in dispute the hire fee was £150 plus VAT per hour. Mr Tolley believed that was a normal commercial rate for supply of a helicopter alone - ie without pilot, fuel, landing charges etc. He and his son paid the company the same rate when they used the helicopter privately.

It was HMRC's opinion that the helicopter was purchased for private use and therefore the associated input tax is not allowable. Initially HMRC was disallowing everything but after an internal review, HMRC's position became that there was mixed usage between business and private. They argued that only a proportion was recoverable. The taxpayer argued that there was no private use because they paid an arm's length rate when the director or his family used it privately.

If a taxpayer uses capital goods for both business and for private purposes the taxpayer has the choice of three possible methods for VAT accounting.

(1) First, he can retain them wholly within his private assets, thereby excluding them entirely from the system of VAT. The Company did not choose that method.

(2) Alternatively, he can integrate them into his business only to the extent to which they are actually used for business purposes. That is accommodated by s 24(5) VATA which provides for apportionment of VAT on supplies to the taxpayer so that only so much as is referable to his business purposes is counted as his input tax. That may be termed "the apportionment method".

(3) Finally, he can allocate those goods wholly to the assets of his business. In that case (a) the input VAT on the acquisition of those goods is immediately deductible in full; but (b) the use of those goods for private purposes is treated as a supply of services for consideration, which is a taxable transaction taxed on the basis of the cost of providing the services. That may be termed "the *Lennartz* method".

In this case the tribunal found as a fact that the helicopter was acquired wholly for business purposes; all use of the asset in the relevant period was business use; and all the disputed input tax was incurred for business purposes. Thus the amount of the input tax to be disallowed should be reduced to nil and the 2010 Assessment is also to be reduced to nil.

http://www.bailii.org/uk/cases/UKFTT/TC/2013/TC02635.html

Chapter 7

Conclusions, discussions and Q&A

7.1 HMRC's Agent Strategy

Before I left ICAS, I was a member of the JTAS group which was tasked with overseeing the implementation of HMRC's agent strategy. In 2010 the initial consultation met with a lukewarm and mixed reception. The initial proposals would have allowed trusted agents to self serve their clients details with limited access to HMRC back office systems. That was welcome because it would improve taxpayer client service eliminating all the delays and errors for which HMRC have historically been responsible.

But the issue that caused some concern was how could HMRC satisfy itself that an agent was trusted. HMRC's solution was to monitor the compliance performance of agents' clients. This project was initially called the Agent View but is now referred to as agent and client statistics. It felt like Big Brother was monitoring agents but technology enables this to be done and HMRC needs to make use of the technological aids available to it.

First a test sample needed to be taken and then the data it generated tested and examined for its usefulness. In essence, the failure of a client should not be indicative of the performance and reliability of the agent so the test was to examine whether the performance of clients had a relevant correlation to the agent's performance. What HMRC are trying to do is see whether the information it can in gather will assist HMRC in risk assessing the agent.

This may seem worrying but in reality HMRC's interest is directed towards the tiny minority of agents who may not be competent or whose performance is seriously unacceptable. Against the background of the Rowland decision reasonable people can understand why this is important. In Rowland the taxpayer was held to have a reasonable excuse because the taxpayer had relied on advice given to him by the agent. That advice was wrong but no penalty was due because the taxpayer had not been negligent.

But the recent case of Peter Stratton has changed that and if a taxpayer relies on incorrect advice from an agent, it may still be a failure to take reasonable care and on discovering the error a penalty may be due.

The agent online strategy which would allow trusted agents to self serve their client's details needs to start with the agent enrolling and being given an unique identity. Potentially, this is a significant issue because it may be simple for a sole practitioner small practice but a large multi-discipline professional practice may want different levels of access for different staff. But let us say that in principle, access to the online self service capability depends on the agent enrolling and giving sufficient information to establish an unique agent reference.

In many other fiscal jurisdictions, there is registration and monitoring of agent competence and performance. Only registered agents who are properly qualified can file returns on behalf of others. But here in the UK there is no restriction at present on who can claim to be an agent and tax adviser. The major professional bodies were keen that there should be a tiered system allowing different levels of access and ability to self serve and that members of professional bodies like ICAS,AAT, ACCA, ICAEW, CIoT, and ATT should be able to get the best access because of their professional qualification. There will be a presumption that members of a recognized professional body will meet the standards allowing them to register but they still need to supply a core of information which includes:

- proper business address
- telephone landline
- an email address.
- Details of with whom you are registered for anti-money laundering purposes
- Bank details

HM Revenue & Customs (HMRC) published their digital strategy in December 2012. This set out HMRC's ambition to deliver a transparent tax system that encourages voluntary compliance, enabled by customer-focused digital services.

As part of this work, the Tax Agent Strategy programme will introduce some new agent services by March 2015. These will:

- help you take more control of your clients' tax affairs
- let you carry out the same tasks online as your clients
- reduce your need to contact HMRC
- make the information about your clients' tax affairs more accurate and up-to-date
- reduce costs to both agents and HMRC
-

http://www.hmrc.gov.uk/agents/strategy/newservices.htm is HMRC's guide and provides an overview of the new services and updates on their development.

- Online agent registration - applying for a Unique Agent Reference
- Applying for self-authorisation
- Viewing payments and liabilities for your clients
- More useful links

Enrolling as an agent is optional and once enrolled it is again a matter of selecting which services you want to self serve. It might be none. But I recommend that this should be viewed as an opportunity for agents rather than a threat.

Once an agent has registered, HMRC will migrate the clients to the new environment and the agent will be responsible for maintaining its own client list. There is likely to be a new, self-administered way to indicate that you've been engaged by a client that could mean an end 64-8s. So if the new agent self serve facility is going to be available by 2015, now is a good time to ensure that the information you want HMRC to migrate for your clients is up to date and correct.

Earlier, I mentioned that HMRC are trying to use information about client performance as a measure of agent performance. Let me be clear that I believe the assurances given by HMRC and that good agents have nothing to worry about from this new development. But the future is going to be different and if you have a lot of dilatory clients who file late and may have poor compliance records, I'd be tempted to review each such client with a view to ditching them if they cannot improve their performance.

The future is electronic and the changes proposed by HMRC are an opportunity to provide a better more efficient service for clients. Now is a good time to start preparing for the future.

7.2 Tax Avoidance: Is paying the right amount of tax at the right time a moral issue?

In January 2014, HMRC published a consultation document which bears all the hallmarks of a tick box exercise to bring forward new powers for HMRC to tackle avoidance. Many professional tax advisers have expressed concern at the proposals:

- Accelerated payments that HMRC will be able to demand from taxpayers before any arguments have been heard before any tax court.
- The ability to issue a follower notice declaring that a taxpayer's arrangements are "the same or similar to other cases" that have been defeated in court - with no right of appeal.

The latter is probably a cause for real concern because it seems to give a power to HMRC to decide that something similar to another case should be treated like that case. In practice, many cases will turn on their individual facts. Subtle differences may produce contrasting decisions on the tax treatment of specific transactions and arrangements.

The problem with the UK tax legislation is its complexity which often produces outcomes that were unintended. The tax system is perceived by many as unfair and in many instances it is unfair. It works because the vast majority of people do not wish to enter the muddy waters of tax avoidance and keep their business and tax affairs simple and commercial.

At Autumn Statement 2013, the government announced that it would, following consultation, introduce a new requirement for taxpayers to pay disputed tax upfront where the avoidance scheme being used has been defeated in another party's litigation through the courts.

Tax avoidance scheme promoters must give HMRC information about schemes they promote under the Disclosure of Tax Avoidance Scheme (DOTAS) rules. Anyone using such a scheme must declare to HMRC they are using a notified tax avoidance scheme. Following the consultationmentioned earlier, the 2014 Budget announced that the government intends to extend the new requirement for taxpayers to pay upfront any disputed tax associated with schemes covered by the DOTAS rules or counteracted under the General Anti Abuse Rule (GAAR).

This new power will remove the cashflow advantage for the taxpayer of holding onto the disputed tax during an avoidance dispute. It will also provide HMRC with additional tools to address a legacy stock of an estimated 65,000 avoidance cases. The new power will only apply to tax avoidance schemes that are disputed by HMRC. The legislation will make it clear that HMRC will only be able to issue an accelerated payment notice where they have first sent the taxpayer an enquiry notice or issued them with a notice of assessment.

7.3. Misinterpreting complex tax law could still lead to penalties

I was a member of the HMRC Powers Consultative Committee which considered the draft legislation and consultation prior to the enactment of the penalty provisions to be found in Schedule 24. Finance

Act 2007. What was known was that the incidence of penalties were going to increase but there were to be safeguards including the right of appeal and an encouragement to make a voluntary disclosure if a mistake was discovered.

It is often possible to read between the lines in tax cases. It was understood that HMRC would be more tolerant of mistakes when made by the poorly educated and if the amounts were modest. The taxpayer's safeguard was the right of appeal to argue that it was a mistake or that the taxpayer had a reasonable excuse for the error which produced insufficient tax liability. It was reassuring to know that an elderly taxpayer struggling to do his best would not be treated as severely as a young professional man who made the same mistake but who would be expected to have a higher standard of knowledge.

7.3.1 In Timothy Harding v HMRC [2013] UKUT 575, the taxpayer has received a termination payment on leaving his employment with KPMG of £109,793. He completed his short tax return but omitted any mention of the termination payment. This was wrong and he was due to pay tax on the excess over £30,000.

This appeal was about the penalty of £2778.18 for careless inaccuracy within a self assessment return leading to understatement of liability to tax imposed by HMRC and confirmed by the FTT. Mr. Harding felt that he had researched the position and believed the termination payment was not taxable and he produced an extract from an article to justify his position. The extract did confirm that termination payments might be exempt from taxation but reading the whole article it was clear that only the first £30,000 was exempt and any excess was taxable.

In essence, Mr Harding was saying that he took reasonable care and researched the position but made a mistake. There was no doubt that he had made a mistake so the issue the upper tribunal was considering was whether he had taken reasonable care and acted as a prudent taxpayer would have done.

The sums involved are relevant. If the termination payment had been small, it just might have been acceptable to do what Mr. Harding had done. But the receipt was for £109,793 and the bigger the sum the more it is appropriate to check and obtain certainty about the tax treatment.

According to HMRC, Mr Harding had used a short tax return when the instructions are clear that such a return should not be used by a taxpayer in receipt of a lump sum termination payment. This was careless and further the extract on which he had relied was not an authoritative statement of the law and his interpretation was flawed as the full article made it clear that any excess over £30,000 was taxable. The compromise agreement which Mr Harding had signed had also made it clear that the excess over £30,000 was taxable.

The Upper Tribunal did not accept that the Appellant, who admits that he considered that the "severance payment" was possibly liable to tax in October 2008, could, by August 2009, reasonably have reached the conclusion that it was definitely not liable to tax. The Appellant is an intelligent person, and held a senior position (such as made him eligible to participate in his employer's profit share and bonus plans reserved for directors) in a company which forms part of a leading accountancy practice. The case he put to the FTT, and to the Upper tribnal, is not credible.

What is clear in practice is that HMRC often challenge the tax treatment of lump sum termination payments and anyone working for a firm of accountants had better take care to get it right. The court ruled that the penalty of 15% of the tax due was correct and that Mr. Harding had failed to take reasonable care when submitting his return.

http://www.bailii.org/uk/cases/UKUT/TCC/2013/575.html

7.3.2. Penalty charged even though taxpayer relied on Professional Advice

In Peter Stratton v Revenue & Customs [2012] UKFTT 578, the First-tier Tribunal has held that a gain made on a disposal of shares was taxable as employment income. The taxpayer, after serving six months as an employee, was awarded some shares. On the sale of the shares, he disclosed the sale as a CGT matter and HMRC contended this was wrong and that the return had been submitted negligently rendering Mr. Stratton liable to a penalty under s95 TMA 1970.

After working for General Healthcare Group for 3 years, Mr. Stratton acquired 250 T shares ("the shares") in GHG in 2001 and paid £6,725 for the shares. On 24 April 2006 GHG was sold to a consortium for approximately £2.2 billion. The consideration was payable in cash and, as regards management's shares of 10%, was paid to management's solicitors, Pinsent Masons, which in turn paid it to members of management.

Pinsent Masons produced a briefing paper which advised:

"**T Shares only:** These shares are taxed under the conditional share regime. The full amount of the gain will be subject to income tax at the shareholders marginal rate, which will be paid under the PAYE system, and national insurance contributions. The amount of PAYE and employees national insurance contributions will be deducted from the consideration to be received by such Shareholders and paid over to HMRC by GHG."

On 10 May 2006 the Appellant surrendered the 250 T shares to GHG and received a payment of £382,748. GHG deducted income tax and NIC from the sum of £382,748 under the PAYE Regulations.

On 20 November 2007 the Appellant filed his self-assessment income tax return for the year ended 5 April 2007 declaring the income of £382,748 but claiming a deduction of the same amount, thereby reducing the PAYE chargeable income to nil and resulting in a refund claim in respect of the £153,099.24 of income tax deducted by GHG. Instead, the Appellant declared a capital gain of £95,894.25 (after taper relief) in respect of his disposal of the shares in his return.

Mr. Stratton was advised in relation to his tax by a firm called Daniels Travers. They advised him that the disposal was one which would be subject to capital Gains tax and not income tax. HMRC opened an enquiry and asked to see any advice received as well as all the documents relating to the purchase and sale of the shares. When these were not provided HMRC threatened to use its access powers to obtain the information.

HMRC asked the advising firm of Daniels Travers to explain the reasoning behind the Appellant's contention that the sale of the shares was not subject to income tax and why the "conditional shares" legislation (section 427 ITEPA 2003) did not apply.

The advising firm seems to have relied on legislation which did not apply to the shares acquired by Mr Stratton but Mr Stratton had sought advice and he argued he was not negligent if that advice was wrong.

The penalty is subject to HMRC's powers of mitigation, pursuant to which the penalty of £23,650 was set at 20% of the extra tax due.

In the view of the FTT, the return was negligently made by Mr Stratton. Daniels Travers seemed either reluctant or unable to engage with HMRC in correspondence in relation to the relevant ITEPA 2003 provisions. Indeed, insofar as Daniels Travers explained the rationale behind the position taken by the Appellant in his tax return, it seemed to ignore the relevant provisions of ITEPA 2003 altogether. Moreover, when Daniels Travers did eventually consider the relevant provisions it appears that they were working from a version of the legislation which did not apply to the Appellant's disposal of his GHG shares. Indeed, in reviewing the correspondence between HMRC and Daniels Travers, it is hard to avoid the conclusion that the applicable ITEPA provisions had not been considered by the Appellant's advisers when they return was submitted. The failure to consider the application of the "conditional share" provisions of ITEPA 2003 was negligent.

He FTT concluded that there was no reasonable basis for the view taken by Mr. Stratton in his tax return. It was plain which provisions HMRC considered to be applicable and no sensible argument was put forward in correspondence by the Appellant or his advisers as to why ss422-427 ITEPA 2003 did not apply.

Where, on advice, a taxpayer has an arguable case that the tax claimed by HMRC is not due, reliance by the taxpayer on that advice will not normally be regarded as negligent for the purposes of penalty proceedings even if it turns out that the advice was incorrect. However, it cannot be correct that in cases where there is no reasonable basis for the advice or the advice was based on a simple failure to consider the relevant statutory provisions, reliance on such defective advice can constitute a reasonable excuse for the purposes of section 118 (2) TMA 1970. Otherwise, a mistake of law or ignorance of the law could constitute a reasonable excuse – a consequence which Parliament cannot possibly have intended.

This decision is a must read for every practitioner. The UK tax regime is complex and voluminous yet ignorance of a provision and reliance on incorrect advice from a professional adviser is not a reasonable excuse so the tax and penalties were collectable and Mr. Stratton will have paid a heavy price for his mistaken claim(s).

http://www.bailii.org/uk/cases/UKFTT/TC/2013/TC02967.html

7.3.3. HMRC right to deny loss relief claim created by tax avoidance scheme.

The Supreme Court has decided in favour of HMRC in the test case of Cotter v Revenue & Customs [2013] UKSC 69. Approximately 200 taxpayers have used the tax scheme which Mr Cotter has used.

HMRC produced a tax calculation based on Mr Cotter's return for 2007/08. It showed income and capital gains tax due of £211,927.77.

On 29 January 2009 Mr Cotter's accountants wrote to the Revenue and enclosed a "provisional 2007/08 loss relief claim" and amendments to his 2007/08 tax return. The amendments added various entries to boxes in the tax return intimating that Mr Cotter had sustained an employment-related loss of £710,000 in the tax year 2008/09 for which he claimed relief under sections 128 and 130 of the Income Tax Act 2007 ("ITA"). In particular, the claim for relief was made in:

(i) the main tax return in box 19 on page TR6 under "Any other information";

(ii) the capital gains summary in box 14 on page CG1 in which the figure of £314,583 was inserted, and under "Any other information" in box 35 on page CG2; and

(iii) the "Additional Information" pages.

In the "Additional Information" pages, Mr Cotter inserted "£395,417" in Box 3 on page Ai3 ("Relief now for 2008-09 trading, or certain capital, losses") and "2007-08" in box 4 on that page ("and the tax year for which you are claiming relief"). On page Ai4, box 17 ("Additional Information") he explained, as he had done on box 19 on page TR6 and in box 35 on page CG2, that his claim was made under sections 128 and 130 of ITA for an employment-related loss which he had sustained in the tax year 2008/09.

Lord Hodge gave the leading judgement. The figures in box 14 on page CG1 and in box 3 on page Ai3 were supplemented by the explanations which Mr Cotter gave of his claim in the boxes requesting "any other information" and "additional information" in the tax return. Those explanations alerted the Revenue to the nature of the claim for relief. HMRC concluded, correctly, that the claim under section 128 of ITA in respect of losses incurred in 2008/09 did not alter the tax chargeable or payable in relation to 2007/08. The Revenue was accordingly entitled and indeed obliged to use Schedule 1A of TMA as the vehicle for its enquiry into the claim (section 42(11)(a)). Mr Cotter had been arguing that he amended his return and so the HMRC could and should have opened an enquiry using s9A TMA 1970/ Mr Cotter lost that argument.

Lord Hodge stated at paragraph 31: "The tax return form for 2007/08 did not show a loss claim which reduced Mr Cotter's liability to tax in respect of that tax year. As the Revenue lawfully commenced an enquiry under Schedule 1A of TMA and elected (under paragraph 4(3)(a) of that Schedule) not to give effect to the claim until the end of the enquiry, there was no postponement of payment of the tax due on 31 January 2009 by giving effect to the claim in the interim. The taxpayer was obliged to pay the amount of tax which had been assessed less any payment to account (section 59B of TMA) and the Revenue was entitled to raise collection proceedings in the county court (section 66 of TMA). I agree with that position."

http://www.bailii.org/uk/cases/UKSC/2013/69.html

7.3.4. Tax avoidance scheme for bonus payments fails

In **Tower Radio Ltd** & Total Property Support Services **Ltd** v Revenue & Customs [2013] UKFTT 387, the First Tier tribunal has ruled that PAYE and NICs should have been paid on bonuses given to directors through companies which were specially set up just to be liquidated and pay out the cash. According to HMRC over 100 other companies used the same tax avoidance scheme to try to pay bonuses without any PAYE or NICs, and that £22 million in additional tax and NIC will be collected.

The avoidance scheme was relatively simple and aimed to take advantage of the differential rates between capital and revenue for individuals. It was promoted in 2003/04 and 2004/05 The idea was to create subsidiary companies as special purpose vehicles (SPVs) funded with surplus cash.

The directors were then awarded restricted shares in the SPVs which were then liquidated and the cash paid out to the directors as distributions in respect of their shares.

The tribunal judge (Peter Kempster and John Whiting OBE who are both past presidents of the CIoT) ruled that PAYE and NICs must be paid on the money received by the directors.

The idea was to take advantage of the way the provisions in the relevant legislation (ITEPA Part 7 Ch 2 (s423 ITEPA 2003)) make no immediate charge to income tax or NICs for an award of 'restricted securities', and then realise the value in the shares in a way that fell outside the subsequent charging mechanism in the legislation.

The shares in the SPV were made to be "restricted securities" by including a clause in the SPV's articles of association which would require the employee who was awarded the shares to sell them to the employer were they to leave (otherwise than by reason of death) the employer within a given period. In such a case, they would receive 95% of the market value of the shares.

An illustration of the tax avoidance scheme is that the SPV (Efforsenrab (1) **Ltd**) was incorporated by London Law Services as a subsidiary of Tower Ltd and 1 million shares were then to be available to the director of Tower. The EGM agreed to the transfer of the 1,000,000 'A' £1 shares in SPV "to the director as a discretionary reward for services performed in the accounting periods to 30 April 2003

(600,000 shares) and 30 April 2004" (400,000 shares). Tower itself would retain a single 'B' £1 ordinary share in SPV.

In tax it is a truism that it aint what you do it's the way that you do it. It seems to me that they got the detail wrong when the directors meetings minuted that "It was noted that the company had traded successfully in that period and continued to do so, and it was considered that the excellent trading result was due to the efforts of [Mr Litman] as a director of the company. … It was agreed that there would be no cash alternative to the aforementioned discretionary award". That is recording that the shares are a reward for services and increases the likelihood that it will be taxed as earnings.

Mr Litman described the use of the funds by SPV as being the conduct of a trade in corporate bonds and Barclays treasury deposits, where he took advice from Barclays stockbrokers on the type of securities and also did some research himself at the time. He claimed he intended to conduct the SPV business for 2 years so that he could obtain the benefit of CGT business asset taper relief but after 3 months he decided to liquidate the SPV because of budget changes in 2004 including the start of the DOTAS regime.

The FTT considered all the arguments and then applied the *Ramsay* principle. At paragraph 143 they recorded:

"All the elements of the transaction were components of a tax avoidance scheme that had no commercial purpose (other than the intended obtaining of a tax advantage). The forfeiture provision in the SPV articles had no commercial purpose and was inserted solely for tax avoidance reasons. From inception it was intended that all the "A" shares in the SPV would be awarded to the pre-designated employee. From inception it was intended that the money box SPV would be liquidated, and the cash distributed to the pre-designated employee, at the earliest time compatible with the technical requirements of the scheme. Any investment activity by the SPV during its short life was solely for tax avoidance purposes."

This decision is worth a detailed read and can be accessed at:

http://www.bailii.org/cgi-bin/markup.cgi?doc=/uk/cases/UKFTT/TC/2013/TC02784.html&query=Tower+and+Radio+and+Ltd&method=boolean

In March 2014 the DJ Chris Moyles received some very adverse publicity having entered into a tax avoidance scheme which has been held to fail. A superficial look at the scheme suggests to me that it fails the smell test. It proves the truism that nobody likes to pay tax.

This scheme has generated very mixed debates from professionals. Some view it as attempted fraud arguing that the participants must have known when they claimed relief that they were not used car salespeople while others observe that tax is now so complicated that even intelligent well educated people cannot get it right and if advised to sign by an adviser they will do so without any understanding.

Can this be taking reasonable care?

The Mehjoo decision has just emerged and fortunately the Court of Appeal has reversed the lower court's decision. We live in an increasingly litigious society and clients expect more and more (often for less and less). The High Court had held that accountants had a duty to advise a client that he may have been a non-dom so that he could then have consulted an appropriate tax specialist to consider what considerable tax avoidance opportunities might be legitimately available to him. In that event, the court held that the client may then have saved the CGT on the sale of his business. The duty of care owed by the accountant had been extended by the accountant offering helpful advice on other matters not covered by the engagement letter.

In Mehjoo v Harben Barker (a firm) & Anor [2014] EWCA Civ 358, the leading Judgement in the Court of Appeal was delivered by LJ Patten. All professional advisers should read the judgement carefully and it is at: http://www.bailii.org/ew/cases/EWCA/Civ/2014/358.html

Mr Mehjoo was born in Iran on 15 October 1959 of Iranian parents. He lived there until 1971 when he was sent to school in England. He has been resident in the UK since that time. After school he became a squash professional for about 9 years during which time he met Mr Purnell. In 1981 he was forced to contest an attempt by the Home Office to remove him back to Iran but he claimed asylum and in 1981 he was granted indefinite leave to remain. Since 1996 he has been a British citizen.

Mr Mehjoo's point of contact in HB was Mr Alan Purnell who had acted as his accountant from about 1980 when he practised on his own account as Purnell & Co. This was taken over by HB in 1991 and Mr Purnell continued to act for Mr Mehjoo after the merger as a partner in HB. In 2003 Mr Mehjoo merged his business with that of Mr Andrew Scott ("Mr Scott") and they became shareholders in a new company called Bank Fashion Limited ("BFL"). In April 2005 BFL was sold for £22m of which Mr Mehjoo's share was £8,508,586.50.

Non-doms have the potential to receive favourable tax treatment on gains on foreign assets just as they do in respect of foreign income. In both cases they are taxed on a remittance basis. But s.275(e) TCGA (which defines the location of assets for CGT purposes) provides that registered shares are situated where they are registered. The shares in BFL (an English registered company) were therefore UK assets in respect of which Mr Mehjoo was liable to pay CGT on any disposal.

Mr Mehjoo sought advice from others and entered into a scheme which failed. If he had tried the Bearer Warrant Scheme ("BWS"),he might have avoided CGT entirely on the disposal of his shares in BFL.

In the event, Mr Mehjoo did not enter into a BWS or indeed any tax saving scheme prior to the sale of the shares. He had discussions prior to the completion of the sale with Mr Purnell and at least two firms of tax advisers, Ford Campbell and MTM (Midlands) Ltd, neither of which suggested using a BWS. But on 16 February 2005 he wrote to Mr Purnell saying that:

> "Obviously until we are 100% sure that the deal will go through I think it is dangerous that I commit myself to any scheme and then there is the consideration of what is the total tax on the deal – has to be worth it!".

The sale of the shares was completed on 19 April 2005 by which time the blocking legislation in relation to a BWS had taken effect. Mr Mehjoo then took tax advice from MTM who recommended that he entered into a tax scheme known as a Capital Redemption Plan ("CRP") which was implemented in August 2005. The CRP was an artificial tax scheme designed to create a capital loss which could be set off against the relevant liability to CGT which it was sought to avoid. Mr Mehjoo paid a fee of £200,000 to MTM for the scheme which was designed to produce a capital loss of £10.5m for the tax year 2005/2006.

HB denied any liability in negligence. They contended that they were not obliged to give tax-planning advice unless specifically asked to do so. This included advising Mr Mehjoo that he was in all probability a non-dom and should seek specialist tax advice in relation to that status.

Common sense emerged from the Court of Appeal which observed "The reasonably competent accountant setting out to advise Mr Mehjoo of the tax consequences of the sale would not, in my view, have been under any obligation to raise for discussion the claimant's domicile unless it was relevant to the CGT liability on the disposal. The accountant would have known that it gave Mr Mehjoo no tax advantages in relation to the sale of the BFL shares unless the situs of the shares could be changed. As this was something which HB neither knew or could have been expected to know was achievable, there was no reason to mention the matter still less a liability in negligence for not having done so"

And at Paragraph 61: "I am not therefore persuaded that HB were under any duty to advise the claimant of significant tax advantages which, to their reasonable knowledge, did not exist."

LJ Lewison went further stating: In my judgment it was impermissible for the judge to infer from the limited occasions upon which Mr Purnell pursued a line of inquiry beyond the strict limits of his retainer that there had been a far reaching (but silent) variation of the retainer, which had the effect of imposing an open-ended and apparently limitless duty upon HB.

Derek Allen