



AAT and ATT Joint Conference Autumn 2014 Sharpen your tax skills Case study – suggested solutions

Michael Steed MA(Cantab), CTA(Fellow),
ATT(Fellow), MAAT

Deputy President of the ATT



Disclaimer

This document has been prepared for use with face-to-face or internet based training programmes and does not necessarily stand-alone. It is intended to be used for training purposes and is not intended to constitute legal or other professional advice or the rendering of legal, consulting or other professional services of any kind.

Users of these materials should not in any manner rely upon or construe the information or materials as legal or other professional advice and should not act or fail to act based upon the information in these materials without seeking the services of a competent legal or other professional.”

No responsibility can be accepted by the presenter, Hawksmere Limited or any member of its group of companies, for any loss occasioned by any persons acting or refraining from acting as a result of information contained in this webinar or related materials. Copyright is reserved to Hawksmere Ltd and this material may not be circulated, reproduced or published in whole or part without the written consent of Hawksmere Ltd.

Contents

- Section A - Business tax;
- Section B – Remuneration strategies for OMBs in 2014;
- Section C -Property taxation;
- Section D –IHT and the family home;
- Section E -VAT.

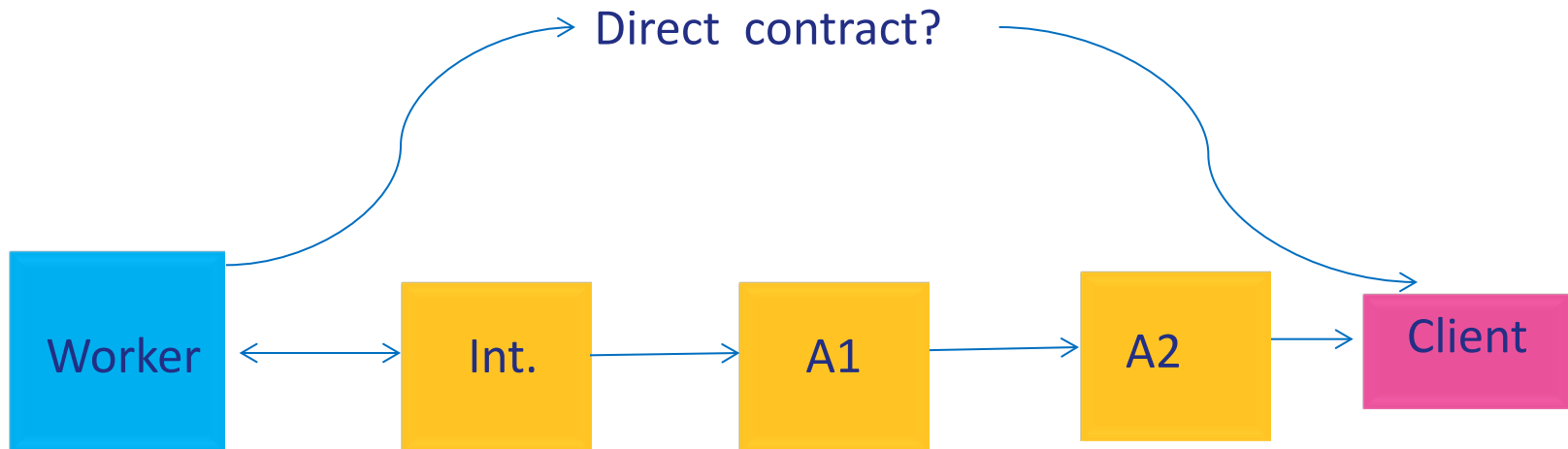
Section A Business tax

1 IR35 – where are we now?

IR35 case study – caught or not?

- The worker (W) has an Intermediary (Int) and gets work through an agency (A1);
- A1 talks to A2 who has the contact with the final client (C), A2 offers work through A1.
- Each leg is governed by a contract;
- Each contract contains clauses covering substitution, control, mutuality etc.

So, pictorially.....



The facts – (continued)

- The substitution clause: there was a theoretical right for Int to provide a substitute;
- It had never been used in practice;
- W, was a highly skilled operative, but the direction of the contract was governed by C;
- The hours were set and timesheets submitted;
- W received some training from C as well as other sources;

IR35 case study

- Using the BETS (in your packs), try and determine whether he would be caught or not;
- Test scores and risk bands:
 - Less than 10 High risk;
 - 10 to 20 Medium risk;
 - More than 20 Low risk.
- What other realistic actions could he take to improve his chances of escaping IR35?

Suggested solution

- Control – neutral – its hard to control a skilled operative, but that does not stop C from giving overall direction;
- There is mutuality in most relationships, but not enough here to establish an employee relationship;
- These facts are very similar to MBF Design Services Ltd v HMRC (2011);
- The Tribunal held that IR35 did not apply.

Other factors in MBF

- W (through Int) had worked for three other clients before C;
- W wore a different security badge;
- He did not attend social functions;
- He did not have his own office and worked from home;
- Interesting IR35 website:
<http://www.ir35buddy.com/business-entity-test/>

2 Partnerships in 2014

Case study- sufficient influence?

The Family Farm LLP has as members, a couple, Fred & Wilma and their adult son Barney.

There is an LLP Agreement, but it has not been amended since before Barney was admitted to partnership. It only refers to Fred and Wilma;

The way that the LLP operates in practice is that Fred, Wilma and Barney all have their say in the running of the business with Fred having a casting vote.

Is this family LLP caught by the new 2014 rules – will Barney be a salaried member and be put through PAYE and NIC?

Case study – sufficient influence?

Although the written agreement was not amended when Barney was admitted, the implied terms of the agreement under which Barney was admitted was that he would have a significant say in the business.

As a result, Condition B is not satisfied and Barney is not a salaried member.

Case study on partnerships

- Your client is a builder who has 6 sub-contractors working for him;
- You do not think that they are properly self-employed as they do not work for anyone else;
- The LLP Act 2000, makes members of an LLP automatically self-employed;
- What would the builder have to do to get over the new 2014 rules?
- Are there any alternative structures?

Case study – suggested solution 1

- Given that ALL of the three conditions (the three fish) have to be met (ie ALL three fish have to be reeled in), otherwise the member is NOT a salaried member, then
- We have to ensure that at least one of the conditions fails:
- Disguised salary;
- Influence;
- Capital contribution.

Case study – suggested solution - 2

- Disguised salary:
 - - possible individual bonuses based on performance;
- Influence:
 - - very unlikely that the builder would allow influence over the affairs of all of the LLP;
- Capital contribution:
 - - weak possibility, but few subbies would have that kind of money.

Case study – suggested solution - 3

- Conclusion:
- Given the new rules, very unlikely that the LLP route would be practical.
- However, there is a real employer/employee issue here, so incorporation seems to offer another protection route for the builder;
- How practical is it that the subbies will be suited to such a solution?

3 Capital allowances

Business tax case study - Russell

- Russell is a sole trader and runs the village garage with his wife Angela and his son Toby.
- Angela works in the business and Toby does too, but they say he is self-employed;
- They have just spent over £100,000 on a new building for repairs and a new MOT testing station.
- Both Russell and Toby have undergone training to be MOT testers.

Business tax case study - Russell

- When you analyse the £100,000 spend, several items catch your eye:
- He has spent around £75,000 on the building and £25,000 on equipment.
- The building works includes:
 - £2,500 on electrical work;
 - £2,000 on thermal insulation;
- Within the £25,000, he has spent:
 - £15,000 on a new hoist and MOT equipment;
 - £3,000 on two big motor-driven roll doors.

Russell - questions

- What are the tax reliefs (if any) that he will be able to claim on his expenditure?
- Give your reasons.
- Quick VAT question:
- Will he be able to claim back the VAT on the MOT testing equipment, given that MOT tests are outside the scope of VAT?

CAs for buildings

- Note how the Capital Allowances Act 2001 deals with CAs:
- S21 – Buildings –List A assets treated a buildings;
- S22 – Structures, assets and works - List B excluded structures
- S23 – expenditure unaffected by SS21 and 22 - List C.

List A – assets treated as buildings

- 1 Walls, floors, ceilings, doors, gates, shutters, windows and stairs;
- 2 Mains services and systems, for water, electricity and gas;
- 3 Waste disposal systems;
- 4 Sewerage and drainage systems;
- 5 Shafts and other structures in which lifts, hoists; escalators, and moving walkways are installed;
- 6 Fire safety systems.

List B – excluded structures

- 1 A tunnel, bridge, viaduct, embankment or cutting;
- 2 Hard-standing, road, railway, car parks, runways;
- 3 Inland navigation;
- 4 A dam reservoir or barrage;
- 5 A dock, harbour pier, marina or jetty
- 6 A dike, seawall weir or drainage ditch;
- 7 Other fixed structures.

List C - Expenditure unaffected by Lists A and B

- Big list in S23 – includes:

- 1 Machinery;
- 4 Manufacturing or processing equipment;
- 7 Sound insulation;
- 9 Refrigeration and cooling equipment;
- 10 Fire alarm systems;
- 11 Burglar alarms;
- 13 Moveable partition walls;
- 15 Advertising hoardings.

Also says that the listings do not affect “integral fixtures” (S33A)

Russell – suggested solutions

- The basic shape of the Capital Allowances legislation is that no tax relief is available on the fundamental fabric of a building;
- However, CAs/AIAs on “**integral features**” such as electrical and water systems are allowed;
- Special rate pool – 8% reducing balance basis;
- Thermal insulation ADDED to a building is allowed, but NOT when the building is being built.

Russell – suggested solutions

- The motor-driven roller-doors will need to have the expenditure apportioned; the doors do NOT qualify for CAs, but the motor does!
- CAs/AIAs will be generally available on equipment;
- The VAT:
- Generally no recovery for outside the scope of VAT activities;
- Some argument for the expenditure being overhead (Abbey National case);

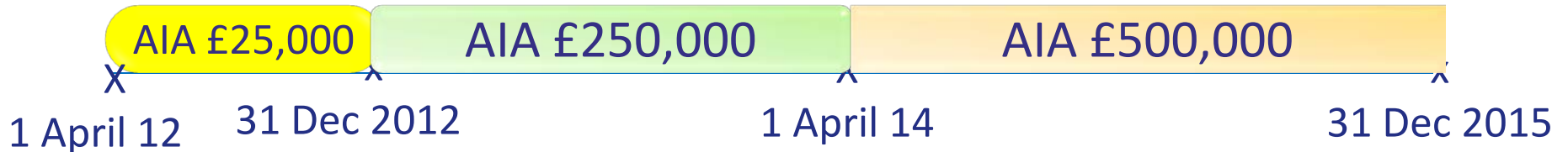
Quick case study – the AIA

- What is the maximum AIA for the following APs?
- Year ended 31 December 2013; and
- Year ending 31 December 2014?
- (Rates on next slide)

The Annual Investment Allowance

- 1/6 April 2008 to April 2010 £50,000
- 1/6 April 2010 to April 2012 £100,000
- 1/6 April 2012 to 31 December 2012 £25,000
- 1 January 2013 to 31 March 2014/5 April 2014 £250,000
- 1/6 April 2014 to 31 December 2015 £500,000
- 1 January 2016 onwards £25,000

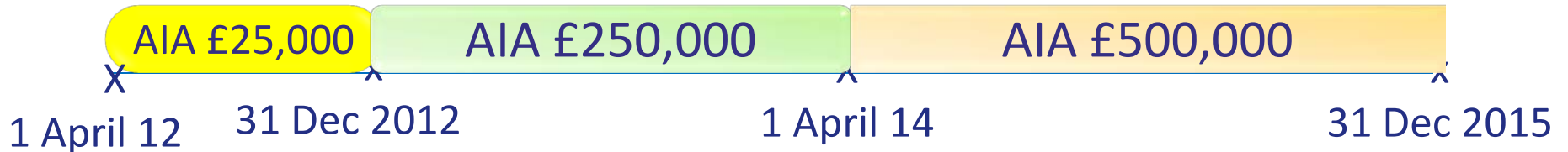
Suggested solution: y/e 31/12/13



Year ended 31.12.2013
(365/365) x £250,000

£250,000

Suggested solution y/e 31/12/14



Year ended 31.3.2014

$$(90/365) \times £250,000 + (275/365 \times £500,000) = £61,644 + £376,712$$

£438,356

Max for expenditure:

1.1.2014 – 31.03.2014 = £250,000

1.4.2014 – 31.12.2014 = unused amount up to £438,356

4 Incorporation

Incorporation case study

- William has a successful VAT registered consultancy business. It was started in April 2007 and his profits over the last three years have averaged £60,000 per annum;
- He spends quite a bit on capital equipment.
- He wants to know about incorporation;
- What tax issues does he need to address?
- Cover: CGT, VAT and capital allowances.

Incorporation case study

- Suggested solutions given per the helpsheets;

Section B

Remuneration strategies for employers and employees in OMBs

2 OMBs – other issues

Case study- Alphabet shares

- Gerry and Frances started a small manufacturing business in the 1980s. Despite the ups and downs in the economy, it has quietly thrived.
- They have adult children, a son and a daughter, who are employed in the company and 5 employees.
- They want to make their children shareholders, but to be able to pay dividends to them differentially (Gerry and Frances are quite comfortable and the children have minor children of their own).
- Will this work?

Gerry and Frances – suggested solution

- Alphabet shares can work in the right circumstances;
- Gerry and Frances can keep their shares (A shares) and create B shares (or even C shares) for their adult children;
- Keep it simple – avoid preference shares – ordinary shares only;
- BIK - by reason of their employment?
- CGT issues for Gerry and Frances – but ER.

Gerry and Frances – suggested solution

- Must consider total distributable profits and max dividend payable per share;
- Like dividend waivers cannot pay a bigger dividend on some shares than others:
 - eg Gerry and Francis 500 'A' shares each
 - 2 children – say 250 'B' shares each
 - distributable profits £24,000
 - max dividend payable £16 per share

3 Don't forget the exempt benefits!

Quick case study - ABC

- ABC Ltd owns a property which has just been sold at a considerable gain;
- The directors have approached you to ask about tax mitigation;
- Would it be possible to make payments into a personal SIPP to get tax relief?
- The two directors/shareholders pay themselves £10,000 pa salary on your advice from April 2014.

ABC Ltd – suggested solution

- A SIPP is just like any other personal scheme, except that the pension holder has choice (or at least some choice) over the choice of investments;
- The directors can make payments into the SIPP up to 100% of their earnings - £10,000;
- The Annual Allowance (AA) is £40,000 in 2104/15 (strictly per PIP);
- So the company can top-up the payments up to the AA;
- Roll forward of unused relief? Max £190k.

Section C Property taxation



Case study - Ghazanfar

- Ghazanfar has a buy to let property which he bought some years ago for £50,000
- It has appreciated significantly in value over this period
- It is now worth £250,000 – there is no mortgage
- He would like to give it to his son who cannot afford to get a foot on the property ladder on his own
- What tax implications should Ghazanfar be aware of?

Ghazanfar - suggested solution

- If it's a direct gift:
 - CGT on the disposal to a connected person
 - treated as mv disposal
 - No SDLT providing donee does not take over mortgage
- IHT – this is a PET, so not immediately chargeable
 - gift may escape tax completely – will depend on whether Ghazanfar lived for 7 years and his available nil rate band if he dies < 7 years

Direct gift of the property – the CGT problem



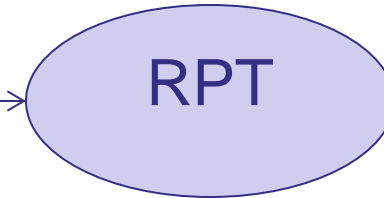
Asset cost £50,000
mv £250,000

No gifts relief
gain £200,000



cost to son
£250,000

Using a discretionary trust (aka RPT)



Asset cost £50,000
mv £250,000

gain £200,000
Holdover relief applies
no CGT

Trustees

Asset cost £250,000
less: HO gain £200,000
= £50,000

Trustees gift to son
Holdover relief applies
no CGT

Cost to son
£250,000 less gain HO
£200,000
= £50,000

This utilises S260, TCGA 1992

Case study – Joyce's rental business

- Joyce owns a number of commercial and residential properties which she rents out;
- This case study addresses the residential properties only.
- She has unfurnished, semi-furnished and completely furnished properties.

Case study – Joyces' rental business

- She has some queries for you:
- She takes deposits from her tenants against forward rent and possible damages and she wants to know how these are dealt with for tax.
- She has fridges and freezers in some of the properties and wants to know how the tax relief works if she replaces them;
- She is spending £20,000 on a kitchen upgrade – it will be a different design from the old one but is the same quality and finish;
- Is her travel to the properties allowable for tax?

Joyce – suggested solutions

- Deposits – how are these held?
- If they are held against future rent, they may become taxable towards the end of the tenancy;
- If they are returnable – then they are not taxable;
- See PIM1051;

Joyce

- Fridges and freezers
- From April 2103, the renewals basis has been withdrawn;
- So for the furnished properties, the 10% W&T allowance is available;
- For the unfurnished (and only partly furnished properties), no tax relief is available, ether on first purchase or renewal (the white goods problem!);

Joyce -the kitchen upgrade

- Provided the kitchen is like for like, then the costs are regarded as repairs and they will be allowable as revenue costs;
- This will include the built-in hobs, etc;
- (this is because the house is the “whole of the asset” and the kitchen is merely part)

Case study - repairs or replacement?

- Peter is a dairy farmer;
- For many years, Peter has only carried out limited repairs to the drive from the road to his farmyard, but the dairy company has told him that the tankers cannot call anymore as the road is too bad
- Peter has the drive repaired. The tarmac was removed and the sub-surface repaired. The drive was then re-surfaced and new kerbing added as necessary to bring the drive up to modern standards;
- Will he get the tax deduction for a repair or is it a replacement, with no tax relief?

Case study – suggested solution

- As a result of the work, the drive was brought back to standard and there was no improvement involved.
- The drive is an asset in its own right but it has not been replaced, merely surfaced. The expenditure is allowable as a repair.
- (see **G Pratt and Sons v HMRC** [2011] UKFTT 416 (TC) where the Tribunal also emphasised that the drive had not changed as a result of the work; notably it did not allow larger milk tankers to be used).

Case study – suggested solution

- It is essential to establish all the relevant facts before reaching any conclusions on the nature of the expenditure;
- Evidence to assist in determining the nature of the work in fact undertaken may include the estimate from the contractor and any written instructions from the taxpayer setting out what work was to be done;
- The case emphasises that all the cases are different and turn on their own facts.

Section D

Inheritance tax

1 IHT and the family home

Case study

- Rez and Hazera are in their 70s. They have two grown up children and four grandchildren. Both are pensioners.
- They have a house worth £600,000 and cash reserves of £200,000;
- They have simple cross wills that leave everything to each other;
- They have asked you to consider the IHT aspects of their deaths and how any IHT liability could be mitigated;
- Assume Rez will die first.

Option 1 – do nothing

- On the first death, no IHT – the spousal exemption operates;
- Everything passes to the survivor;
- On the second death – two nil rate bands to put against the estate;
- But £150,000 left exposed to IHT at 40%;
- £60,000 liability.

Option 2 – Lifetime gifts

- Rez and Hazera could gift some of their estate in lifetime;
- The cash would be the most obvious asset – no CGT issues;
- PET for IHT – 7 year survivor rule;
- Annual exemptions to put against the gift;
- Need to watch their standard of living and their personal needs.

Option 3 – Gifts to the children

- Rez could gift his interest in the property to the children as an outright gift up to the value of the NRB (£325,000);
- Or could be done by a deed of variation;
- Uses some or all of Rez's NRB;
- Hazera becomes the sole legal owner of the property – the children have an equitable interest;
- She may not be happy about this

Option 3 – Gifts to the children

- On the second death (Hazera's), her share will attract IHT, but she has her own NRB to set against any liability;
- CGT position:
- There will be an uplift to mv on Hazera's death;
- Any lifetime gift of the property will be covered by her PPR;
- No uplift on the children's share;
- No PPR either, unless they occupy.

Option 3A – Transfer property into a DT

- Rez writes a standard NRB DT into his will;
- On his death, the value of the house up to the NRB is transferred into a DT;
- IHT on first death (here Rez) – none;
- Periodic charges on the trust – need to consider- available NRB? –uplift in value? Life expectancy of Hazera?

Option 3A – Transfer property into a DT

- Hazera will be a beneficiary of the trust as she will continue to live in the property because of her own tenancy on common;
- No IHT on her death – S49, IHTA 1984;
- Possible HMRC challenge – does she have an IIP?
- CGT position – no CGT uplift on Hazera's death;
-

Option 3B – debt or charge alternative

- A popular alternative to the DT route;
- On Rez's death, his interest is transferred to Hazera.
- In return, Hazera agrees that her estate will owe a debt to the trustees of Rez's DT which will be satisfied when the property is sold;
- The trustees will take a charge over the property.
- The debt is an allowable debt/charge;
- SDLT charge under the debt route?

Summary – uses of the DT/debt/charge routes

- Since NRB transferable to surviving spouse, these schemes arguably not quite so important;
- However, used if second marriage – ensures that at least some of the estate goes in the right direction!
- So, protects the children if widow runs off with the toyboy gardener!
- Might also help avoid wiping out the estate in the event of care-home fees.

Section E

Value Added Tax

1 Input tax recovery issues

Case study - input tax recovery on cars

- Your client is about to start as a self-employed renewable energy consultant;
- He will work from home;
- He wants to buy a new car and wants to know if it is possible to reclaim the VAT on the car?
- What are the issues and are there any planning possibilities here (assume that he will be VAT registered from Day 1)?

Case study - input tax recovery on cars

- What difference would it make if he bought a dual-cab pick-up instead?
- Is the VAT on pool cars generally recoverable?
- Can a taxi driver recover VAT on the taxi, even if he drives it home each night?
- If his wife accompanies him on business, can his business recover the VAT on the travel and subsistence costs and hotel bills?

Case study – VAT recovery on cars

- Basic shape of the legislation is that input tax recovery is barred, to tax the private use;
- The key phrase is “making the car available for private use!”
- From the Input Tax Order (SI 1992/3222);
- So you need to put it beyond availability!

Case study – input tax recovery on cars

- This is virtually impossible as a sole trader working from home;
- However, if the client was to form a limited company, then it becomes appreciably easier;
- See Elm Milk Ltd (CA) (2006) and upheld in Shaw (2007);
- Need to be clear about the BLK point too – singing from the same hymnbook?

Input tax recovery

- A dual-cab pick-up is not a car as defined (using the VAT definition (ie NOT the CA definition));
- So no problems with recovery;
- Proper pool cars recoverable (no personal use) – but can't go home at night;
- Taxi recovery – the personal use is ignored and the VAT is recoverable;
- T&S will depend on whether she helps in the business, otherwise apportionment;

2 VAT and the internet

Case study - VAT on internet selling

- Your UK client (a limited company) sells computer accessories (goods) over the internet and sends them by post;
- These are sold to B2C customers in the UK, the EU and in third countries (ie outside the 28 Member States of the EU);
- The company has also produced an App which initial trials suggest will be a successful business venture;
- The App will be downloaded from a UK server and will be sold B2C all over the EU and in third countries;

VAT on internet selling

- Questions:
- What is the VAT treatment of sales of the goods to B2C customers?
- What is the VAT treatment of the sales of the App to B2C customers?

VAT treatment of the sales of goods

- These are B2C sales, so the following applies:
- UK customers – charge UK VAT;
- EU customers – charge UK VAT until the distance selling threshold is reached in each Member State (either 25K or 100K euros – see related material) - then stop charging UK VAT and start charging local VAT (this addresses the market distortion);
- 3C customers – a zero-rated export.

The VAT treatment of the App B2C sales – up to 31 December 2014;

- UK customers – charge VAT (the effective use and enjoyment rules do not apply);
- EU customers – charge UK VAT, to tax the consumption in the EU;
- 3C customers – outside the scope of UK VAT (the effective use and enjoyment rules do not apply).

The EU VAT treatment from 1 January 2015

- Sales of e-services (this includes the App) B2C will be charged to VAT in the Member State where the customer belongs;
- Could mean multiple registrations;
- But the Mini-One-Stop-Shop (MOSS), is available to allow on registration only (here in the UK – see next slide) and the relevant VAT will be sent to the other Member States' tax authority;
- Sales to 3C customers no change in operation (outside the scope – Para 16, Schedule 4A, VATA 1994).

The MOSS

- As an alternative to obtaining multiple VAT registrations in each Member State where a supplier has a customer, affected suppliers may be able to opt to account for VAT across the EU via a single electronic declaration. This return can be filed with the tax authority where the supplier is established;
- The MOSS scheme will be similar to the one presently in place for non-EU suppliers and will allow for the value of B2C supplies made in all 28 EU Member States to be reported on a single electronic return (in the UK, via HMRC's website).