Tax update – 31 August 2015

In this month's edition of the tax update we look at:

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1. Improving compliance and respecting the law

I read the autobiography of Norman Wisdom recently. I remember seeing the late Sir Norman Wisdom at a Glasgow Theatre in the 1960's and appreciating that he was a great comedian and a very skilled musician. Far from being the Gump he performed, he was an astute self-educated man. In the tax world, he is 'famous' for the decision on bullion silver which held that an isolated transaction of silver bullion could be trading. I had a lot of sympathy for the late Sir Norman because he was paying tax on his trading profit at 91.5% and also because the judge failed to recognise the possibility that an individual could enjoy pride of possession of silver bullion. What amused me was that Sir Norman recovered all the tax which he felt he had been taxed wrongly upon by then taking advantage of Stock Relief. My point is that if taxpayers feel aggrieved, they may well investigate ways to recover the tax they have paid and which they considered was too much.

I remember listening to Sir Nick Montague in 2003 when he quoted Oliver Wendell Holmes and "Tax is the price we have to pay for living in a civilised society". But I disagreed with Sir Nick's hypothesis that there was a moral obligation to pay tax and that it was morally reprehensible for anyone to consider tax avoidance. I had been taught and accepted the principle that there is a moral obligation to pay the right tax at the right time but the onus lay with the legislators to write clear and certain tax legislation.

I happen to believe that in the UK the tax legislation is a voluminous, complex, uncertain mess and is quite inappropriate for a self-assessment regime. However, it is evident that the attitude of the Courts has changed in recent years and there is a greater tendency to interpret tax law on a purposeful basis, trying to identify a spirit or intention within the law, especially if that spirit denies a tax advantage that might be useful in an avoidance scheme.

While no one should condone evasion (which is illegal) attitudes are changing towards avoidance and it is becoming less acceptable. Expressed differently, the balance has been swinging in recent years towards HMRC's interpretation of the law. For this reason, I believe that it is important that taxpayers have safeguards that protect their rights and an important safeguard is the right to appeal against a decision of HMRC with which you do not agree.

HMRC officers make mistakes but an important safeguard within the system is the internal review mechanism which should ensure that mistakes by an individual are identified and sorted. Unfortunately, the evidence is strong that for too many taxpayers, the HMRC internal review process does not work satisfactorily. This may be a cultural failing, such that officers think in a similar way but it must be a matter of public concern that too many compliant taxpayers have to appeal to the Tribunal to have disputes resolved. At least access to the Tribunal could be on a basis of no costs being awarded and an individual could represent themselves and present their appeal.

This looks set to change and the Ministry of Justice has a consultation ongoing (it closes on 15 September 2015) with proposals to introduce and /or increase charges for accessing Courts and Tribunals. For the First-tier Tribunal (FTT) for paper and basic cases an issue fee of £50 is proposed, and for standard and complex cases an issue fee of £200. Where cases go to a full hearing, fees are proposed as follows: basic £200; standard £500; complex £1,000.

I find such a diminution in the safeguards to protect taxpayers worrying. Many of the disputes which appear before the FTT involve relatively modest amounts of tax (or interest or penalties). Forcing taxpayers to pay a fee before they can appeal to the tribunal will deny many compliant taxpayers a

right of appeal. The taxpayer will need to make a decision based on commercial considerations and not on what is right or wrong.

Oddly enough, I can support the idea of there being fees charged if an appeal is made to the Upper Tribunal and beyond. For the Upper Tribunal, there would be a fee of £100 to seek permission to appeal; £200 for a permission hearing (where permission has been refused on the papers); and £2,000 for a substantive appeal hearing.

It may appear totally unrelated but I am worried that HMRC powers and approach are getting unacceptable. I'll return to the barrister case which demonstrates that not only has HMRC behaved badly with a distinct lack of judgement shortly.

On 22 July HMRC published a consultation on improving large business compliance. That is laudable but the content is disturbing. The consultation makes three proposals:

1. A legislative requirement for all large businesses to publish their tax strategy,
2. A voluntary 'Code of Practice on Taxation for Large Business' which will define the standards of behaviour expected by HMRC of its large business customers, and
3. A more narrowly targeted 'Special Measures' regime aimed at large businesses that are perceived to undertake aggressive tax planning continually, or to refuse persistently to engage with HMRC in an open and collaborative manner.

I have read the tax strategies of a number of large businesses and I have often felt that the fine words in the strategy were not reflected in the debate and discussion which appeared at a tribunal hearing. More importantly, tax planning is a very emotive issue and very subjective. What one man finds objectionable is perfectly acceptable to another, especially if the plan or scheme works.

I do not mind aspirations such as the first two proposals but that third proposal is subjective and, in my view, dangerous. If the perception is that of HMRC then this should not be accepted.

The consultation document (41 pages) can be read **here.**

Responses are invited by 14 October 2015

There is always a danger of viewing history through a distorted glass and I acknowledge that my solitary opinion may not be shared. But I have been concerned over a period of many years that many officers in HMRC appear to lack judgement. Tax is complex and disputes are inevitable but far too many cases that get to appeal suggest that the level of skill and judgement within HMRC is declining. In colloquial terms, it appears that "they have lost the place!"

In the next VAT update due on 14 September, I'll review and comment upon **Garrod v Revenue & Customs (VAT) [2015] UKFTT 353.** The taxpayer is a barrister and required to complete VAT returns. He was prevented from doing this because he objected to ticking the box which confirmed he had read and understood HMRC's terms and conditions. HMRC were wrong to include that requirement in the return and the judgement makes a very interesting read. I was appalled to read the case because HMRC should never have taken such an appeal to tribunal. HMRC were so wrong that their conduct and arguments deserve the most serious criticism. Historically, I had a lot of faith in HMRC officers and I could respect their position even though they were wrong. This case illustrates that HMRC cannot be trusted to employ sound judgement or respect taxpayers rights.

2. IHT – were furnished holiday lets a trade and qualified for BPR?

It is wrong to suggest that the only certainties are death and taxes. Taxes are very uncertain. and for many IHT is viewed as punitive and unfair. It rarely catches the rich and well advised and it does not affect the poor but for those in the middle caught with a 40% tax on the wealth they have accumulated out of income which had been taxed, it can seem unfair and punitive.

In **Anne Christine Curtis Green v Revenue & Customs [2015] UKFTT 236**, there were a number of minor issues including whether evidence should be heard but the interesting point was whether furnished holiday lettings were a business and could qualify for Business Property Relief (BPR).

Mrs Green runs a business called Flagstaff Holidays ("the Business"), which lets five units of self-contained holiday accommodation in a property called Flagstaff House, Burnham Overy Staithe, King's Lynn, Norfolk ("the Property"). She had transferred 85% of the Business to a settlement called the Mrs ACC Green Settlement ("the Trust "), this was a lifetime transfer valued at £1.643,500. If BPR was available the tax was nil but if chargeable then the tax was considerable.

The Property is divided into five units, each of which is available for holiday letting on a self-catering basis. Two units are in the main house, and three – Flagstaff Cottage, the Garden House and the Boat House – are within the curtilage of the main house. Each unit has a well-equipped kitchen with a dishwasher, freezer, fridge, microwave and cooker, as well as crockery, cutlery, glassware, pans and utensils. The units share an outside laundry room with a washing machine, tumble drier and ironing board. The Property has Wi-Fi but only a weak mobile phone signal. Looking at four years together, the accounts show that the total income of the Business was £291,236, or an average of £72,809. When VAT is added, the average income each year was £87,371.

HMRC contended that although this was clearly a business the property was held mainly as an investment. The Business supplied linen and towels, furniture and equipment, Wi-Fi, high chairs, pots and pans, a caretaker, and a welcome pack. It was clear from the documents that the guests did their own laundry and had to leave the premises clean and tidy before they left, so there was nothing special in the way of extra services.

HMRC argued that even if it was accepted that work was carried out by Mrs Green that work was incidental and minor in comparison to the work of maintaining the property. As a result, the Business is still on the "investment" side of the line. Most of the activities are general tasks associated with maintenance and upkeep of the Property, and only a few could be classified as non-investment - cleaning, the welcome pack, linen and towels, furniture and equipment, the occasional assistance of a caretaker.

Anne Redston found in favour of HMRC. No BPR was available. Interestingly, the underlying principle is that it is the nature of the work done rather than the volume of the work done which will decide the outcome. The fact that fie units were involved and the income was substantial did not change the fact that the property was held mainly as an investment.

3. HMRC wins regarding payment made by individual to allow the sale of shares

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.

The FTT decided in favour of Mr Blackwell allowing him to deduct the expense which he had incurred but this decision has been reversed by the Upper Tribunal in R&C v Julian Blackwell **[2015] UKUT 0418.**.

Mr Blackwell had owned shares in a family business, and his vote was necessary to secure any special resolution of the company and for other important decisions in relation to the company. He entered into a confidential agreement with a potential buyer in return for £1 million which bound him to vote his shares in favour of an offer from that buyer. In due course, two of the other directors of the company approached him. He agreed to sign a confidentiality agreement with them, following which

they told him that a US firm was prepared to make a much higher offer. The taxpayer could not agree to the proposed take-over without breaking his original agreement. Eventually, he paid £17.5 million to the first potential buyer, and he then became free to vote in favour of the takeover. He claimed that this amounted to enhancement expenditure on his shares.

I have serious doubts about the reasons given by the UT for overturning the decision of the FTT but the fact remains that a decision of the UT is a precedent. The UT concluded that the asset to which TCGA 1992 s 38(1)(b) applies is not the asset in the vendor's hands, but the bundle of rights and obligations which would be acquired by a purchaser. This seems to me to be an interpretation that is highly suspect and is certainly not in the spirit of the legislation.

The £17.5 million payment was not being reflected in the state or nature of the asset which the purchaser bought, as, under general contract law, rights do not bind third parties in the absence of a proprietary interest. I recommend that the judgement deserves a careful read and consideration of the reasons given which led to Paragraph 77 and its conclusion that the expenditure needs to be reflected in the asset acquired by the buyer.

This decision could have wider repercussions. For example, it is accepted that a payment made by a landlord to get rid of a sitting tenant is an allowable cost for CGT but the purchaser acquires a freehold property unencumbered by a tenant but the payment is not reflected in the asset acquired by the buyer.

S.38(1)(b) states: (b) the amount of any expenditure wholly and exclusively incurred on the asset by him or on his behalf for the purpose of enhancing the value of the asset, being expenditure **reflected in the state or nature of the asset a the time of the disposal**, and any expenditure wholly and exclusively incurred by him in establishing, preserving or defending his title to, or to a right over, the asset, and I have added the emphasis to the statute above. Mr Blackwell tried a second argument that the expenditure was made to establish, preserve or defend any right over his asset and this argument also failed at the UT

The UT acknowledges that the decision appears unfair and denies Mr Blackwell a deduction for a cost which he incurred.

4. HMRC publishes updated guidance on employee expenses for business travel

At 78 pages this should be required reading for anyone needing to advise on employee business travel and expenses. **This guide** describes the tax and National Insurance contributions (NICs) treatment of business travel by employees. It explains the HMRC view of what counts as 'business travel' and, for employees other than those using their own vehicles, the kinds of expenses which qualify for tax relief. See booklet 480 'Expenses and benefits – a tax guide*'* Chapter 16 for information about tax relief for mileage expenses in an employee's own vehicle. It applies to all employers who pay travel expenses whether:

- by reimbursing employees' business travel costs
- by paying directly for business travel for employees
- by providing travel facilities for employees

5. New advisory Fuel Rates from 01 September 2015

Not surprisingly they have gone down slightly.

Derek Allen
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The views expressed in these podcasts are Derek Allen's personal views and do not necessarily represent AAT policy or strategy.

There will be another general tax podcast updating AAT members on recent developments and decisions available on the website on 30 September 2015. For those interested in VAT, there should be an update available on 14 September 2015