Tax update – 31 December 2016

AAT TAX Update 31 December 2016
In this Month's edition of the Tax update we look at:
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1. Devolution and Tax raising powers for Wales

Although Scotland has had limited tax raising powers devolved to its government, those powers have not been exercised in a dramatic way. Now Wales has been granted limited tax raising powers. According to the press release:

- The Welsh Assembly will take on responsibility for Welsh Rates of Income Tax (WRIT) from April 2019. (Subject to the removal of the referendum requirement through the current Wales Bill and the Welsh Government setting out its intention to introduce Welsh rates of income tax to the National Assembly for Wales)
- The Welsh Government will have a fair level of funding for the long term, taking into account Welsh tax capacity and treating population change consistently across tax and spending
- The amount of capital borrowing available to the Welsh Government will be doubled up to £1bn

The fiscal framework sets out how the Welsh Government will be funded following the devolution of stamp duty land tax, landfill tax and Welsh rates of income tax. Under the Wales Act 2014, the following tax powers are being devolved:
1. Stamp duty land tax from 2018-19
2. Landfill tax from 2018-19
3 Welsh rates of income tax from 2019-20

Scotland:- In Edinburgh on 15 December, Scottish finance secretary Derek Mackay delivered his draft Budget for 2017/18. He retained the same rates of tax as in England for basic, higher and additional rates (20%, 40% and 45%). The Scottish government has decided not to follow Philip Hammond's example of raising the higher rate income tax threshold by £2,000. Instead, the threshold for Scottish taxpayers will be lifted by only £430 – in line with the increase in RPI.

This is a proposal to introduce a different higher rate income tax threshold in Scotland compared to that which applies in the rest of the UK. The differential is so small that it is unlikely to affect behaviour but it is the first step in a process that is likely to bring increasing differentiation and added complexity. It also makes Scottish earners the most highly taxed earners in the UK. The changes do not apply to unearned income like interest and dividends.

https://www.gov.uk/government/news/new-fiscal-framework-provides-long-term-financial-security-for-wales

2. Landlord's receipt for dilapidations was capital

The distinction between Capital and Revenue can be very significant for the tax outcome. Often, a capital receipt is effectively tax free. In Thornton v Revenue & Customs (Income tax – discovery) [2016] UKFTT 767 HMRC argued that they had made a discovery and sought additional tax in the sums of £6,651.28 and £8,041.54 for the years 2011/2012 and 2012/2013 respectively. At the heart of this appeal was the treatment of a receipt by Mr Thornton of £250,000 on Friday 30 July 2010

On 17 October 2006 Mr Thornton took entry to 18 flats, known as Jordan House, Nairn, for which he had exchanged missives in six different sets of missives. All of those flats had previously been the subject matter of a lease between Silk Estates Limited and Albyn Housing Society Limited ("Albyn"). The lease for the flats was a standard tenants repairing and insuring lease whereby the tenant was responsible for the upkeep of the flats. They did not do so. The lease had approximately five years still to run but the tenants wished to be released as the properties were no longer habitable and were unoccupied.

Mr Thornton was very anxious indeed to regain possession of the flats in order to prevent yet further disrepair and he accepted a compromise payment of £250,000 releasing the tenants and giving him possession of the properties. Mr Thornton used the funds that he received in order to repair the building and expenditure is still ongoing. In February 2013 Mr Thornton's then agent confirmed that £273,000 had already been expended on repairs. The flats remained vacant for at least ten months not least because, in his opinion, the building was dangerous.

If the receipt was attributable to rental income it would all be taxed. If it was attributed to capital and applied to capital expenditure to bring the block of flats back to a habitable state then it would essentially be free of tax. As an observation, the evidence produced and the bundles used for this case were criticised as being short of the standard required. HMRC deserve serious criticism for such a failing.

The HMRC officers relied on the Property income manual which is not law but does set out the HMRC interpretation of the law. This can be found at https://www.gov.uk/hmrc-internal-manuals/property-income-manual/pim2020

This HMRC interpretation is wrong and will now have to be rewritten. Landlords have faced a lot of change recently and a newsletter to clients on this issue might be worthwhile. Some landlords may be entitled to a claim for a repayment of tax.

The tribunal identified that the nature of the liability in this particular case was to make good the fall in capital value attributable to, and calculated by reference to, the dilapidations that the tenant had failed to make good. When the lease was terminated, due to the inaction of Albyn, Mr Thornton had suffered a permanent diminution in the capital value of his investment and the settlement was to make good that loss.

http://www.bailii.org/uk/cases/UKFTT/TC/2016/TC05494.html#_ftnref4

3. Is biodegradable material used to generate methane Landfill and liable to tax?

In Patersons of Greenoakhill Ltd v HM Revenue & Customs [2016] EWCA Civ 1250 the issue was about the liability to landfill tax ("LT") of a landfill site operator ("LSO") where biodegradable material (material which decomposes through the action of microbes) is deposited at the landfill site, and produces methane which the LSO can extract and turn to account in making electricity.

Normally, LSOs have to pay LT on any material which is disposed of "as waste" on their landfill site (Finance Act 1996 ("FA 96"), section 40(2)(a)). An LSO, however, which uses materials, rather than placing them into the landfill site as waste, is in general not liable to LT. This is because a person is treated as disposing of material as waste if, and only if, he disposes of it "with the intention of discarding the material" (FA 96, section 64).

In this case, the LSO, the appellant ("Patersons"), acquired both biodegradable and inert materials for landfilling at its site near Glasgow. It was obliged to remove the methane as a term of its licence and use it to create electricity. It now seeks a repayment of LT paid in respect of the biodegradable material for the three years (2006 to 2009) when biodegradable materials were deposited into the landfill site and produced methane. Patersons installed machinery which enabled it to convert that methane into electricity and sell it to the National Grid.

The question whether Patersons disposed of the material as waste for the purposes of section 40(2)(a) must be decided at the date of deposit by reference to the material in the form it then was. At that time, there was no methane.

Section 40(2) sets out four conditions that have to be established for a disposal to be a taxable disposal. This appeal concerns only the first condition. Section 40(2) provides:
(2) A disposal is a taxable disposal if—
(a) it is a disposal of material as waste,
(b) it is made by way of landfill,
(c) it is made at a landfill site, and
(d) it is made on or after 1st October 1996

Section 64 explains what is meant by "a disposal of material as waste" and so far as material it provides that:
(1) A disposal of material is a disposal of it as waste if the person making the disposal does so with the intention of discarding the material.
(2) The fact that the person making the disposal or any other person could benefit from or make use of the material is irrelevant….

The UT dismissed the appeal on the ground that Patersons did not use the material it deposited at its landfill site to generate electricity. The generation of electricity was the inevitable result of decomposition. What was deposited in the landfill site was waste and liable to tax. The Court of Appeal has upheld that view.

http://www.bailii.org/ew/cases/EWCA/Civ/2016/1250.html

4. HMRC produce draft guidance on hybrids and mismatch legislation

The guidance (404 pages) is open for consultation until 10 March 2017 and yet the new legislation applies from 1 January 2017.
This draft guidance is provided to assist understanding of the application of the hybrids mismatch legislation, which take effect from 1 January 2017.
The examples contained are based upon a selection of those contained within the OECD 'Final Report on Neutralising the Effects of Hybrid Mismatch Arrangements', with additional draft examples dealing with hybrid transfers and permanent establishments.
I read recently that HMRC are concerned that the advance assurance service is currently experiencing a high volume of demand. This seems natural bearing in mind the increasing complexity of the rules, and the desire of taxpayers for certainty before claiming reliefs. In 2016 we saw examples of HMRC seeking penalties if the taxpayer claimed a relied to which that taxpayer was denied on a technicality.
Tax is complex and the increasing complexity is a worry for all practitioners and advisers. Venture capital schemes (VCT) seed enterprise investment schemes (SEIS), enterprise investment scheme (EIS) and a soon to be expanded social investment tax relief (SITR)), all place demands on this essential service. HMRC are guilty of abusing the penalty regime and seeking penalties in cases where a complex piece of tax law has been mistakenly applied. Not surprisingly, Taxpayers want certainty and seek advance assurance in complex areas.
We need stability and simplification in tax. It would reduce the cost of compliance for everyone.
https://www.gov.uk/government/consultations/hybrid-and-other-mismatches-draft-guidance

5. New Advisory Fuel rates apply from 1 December 2016

Visits to garage forecourts will have shown that fuel prices are rising. Advisory fuel rates in pence per mile that can be used by employers and employee company car drivers changed from 1 December 2016, as noted in the table in the following page:

From 1 December 2016

Petrol	***Diesel***	***Lpg***
1400 cc or less 1401 – 2000 cc 2001 + cc		
11p	14p	21p
1400 cc or less 1401 – 2000 cc 2001 + cc		
7p	9p	13p
1600 cc or less 1601 – 2000 cc 2001 + cc		
9p	11p	13p

1 September to 30 November 2016

1400 cc or less 1401 – 2000 cc 2001 + cc		
11p	13p	20p
1400 cc or less 1401 – 2000 cc 2001 + cc		
7p	9p	13p
1600 cc or less 1601 – 2000 cc 2001 + cc		
9p	11p	13p

Hybrid cars are treated as either petrol or diesel cars for this purpose. HMRC has continued to confirm that people can use the previous rates for up to 1 month from the date the new rates apply VAT element of mileage allowances.

Derek Allen
30 December 2016

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

This is the final podcast for 2016. Thank you for reading and listening. I hope that the New Year brings you all that you wish. Happy New Year.