Tax update – 31 July 2016

AAT Tax Update 31 July 2016

In this Month's edition of the Tax update we look at:
1 Finance Bill 2016 progress
2 Penalty if tax plan implemented incorrectly?
3 Footballer's mistake gets penalty
4 Sporting Events – limited income tax exemption
5 Tax avoidance – take care and be well advised

1. Finance Bill 2016 Progress

We have a self assessment regime in this country and yet the volume and complexity of tax legislation is growing at an alarming rate. By July, the Finance Bill 2016 had finished at Committee Stage but had not been enacted and would now be considered by the House at Report stage beginning in September.

Last year it was reported that the UK tax legislation had reached 22,298 pages and yet this Finance Bill adds another 190 clauses and 25 Schedules the last of which is a schedule on the Office of Tax Simplification. Politicians should hang their heads in shame because they are responsible for creating such a mess of impenetrable rules that few people understand.

The latest version of the Finance Bill is available at http://www.publications.parliament.uk/pa/bills/cbill/2016-2017/0047/17047.pdf

Politicians crave the oxygen of publicity and I worry that the new Chancellor, Philip Hammond, will think it necessary to introduce significant change. His justification might be that additional revenues are necessary to cope with the different business and economic environment that the vote to leave has created. Hammond has said that he saw no need for an emergency Budget and immediate cuts in corporation tax, preferring instead to take stock over the summer period and prepare a detailed Autunm Statement.

David Gauke has been promoted from Financial Secretary to the Treasury to Chief Secretary. Jane Ellison MP has been appointed as Financial secretary to the Treasury.

2. Penalties if tax plan implemented incorrectly

I suspect that Mr. Terrence Raine will feel aggrieved and the victim of a serious injustice at having a penalty imposed because his return was incorrect and did not include the 'dividends' he paid to his partner. If the couple had been married, I suspect that the HMRC argument might have failed because the company was matrimonial property and the couple's intention had been to share ownership and dividends.

Mr Raine and his partner had completed annual tax returns reporting that they each received dividends from the company which Mr Raine had set up with the intention of the couple owning 50% of the shares each. The company had been bought off the shelf and both the issued shares were in Mr. Raine's name. HMRC discovered that the share ownership was not as the couple intended and decided that all of the dividends were properly to be assessed in Mr. Raine. Adding insult to injury, they concluded that he had been negligent in relying on professional advisers to organise things as he intended and negligent not to have read and understood the accounts and returns which he had signed over the years.

In Terrence Raine v R&C [2016] UKFTT 0448, the decisions under appeal were:

Years	Decision	Amount
2005-06	Assessment	£4,999.95
2006-07	Assessment	£3,406.72
2007-08	Assessment	£15,000.08
2008-09	Assessment	£5,499.90
2009-10	Assessment	£4,847.40
2010-11	Assessment	£2,368.80
2005-06 - 2007-08	Penalty determination	£3,510.00
2008-09 - 2010-11	Penalty assessment	£1,907.41
2008-09 - 2010-11	Decision not to suspend penalties	n/a

Mr Raine is a sixty-nine year old Chartered Engineer. In 2000, after being made redundant, he formed Linkdrive Solutions Limited. He was advised to trade as a limited company because he could then be paid gross and it would help to get work. It was a simple job to register both the Appellant and Ms Hamilton (his long time partner) as its officers and shareholders. The Appellant would be appointed a director and Ms Hamilton the company secretary.

Having died in 2013, Ms Hamilton was not available to give evidence but in earlier statements she had confirmed that her understanding was that the shares were to owned one each and she had provided a secretarial service on a daily basis, liaising with clients and agencies in organising meetings and reports. She had also acted as a "sounding board" for the Appellant and had visited him frequently when he was away on assignments.

The simple task of allocating one share to each of Mr Raine and Ms Hamilton was never achieved. Even worse, the annual return to Companies House said that both shares were owned by Mr Raine and he signed that return. After the company moved into profit in 2004 the Appellant became aware that many other similar companies did not operate their companies as he had. They took a lower salary and declared a dividend to shareholders in respect of profits which they said was a more tax efficient method of dealing with payments/salary.

After taking advice, Mr Raine instructed his advisers to arrange the paperwork for a dividend of £10,000, £5,000 to be paid to him and £5,000 to be paid to Ms Hamilton. The Appellant says that it was explained to him that the dividends had to be paid on a per-share basis.

At the formation of the company, the mistakes regarding the shareholding were made by the advisers. The errors arose from a simple error that was thereafter compounded as dividends were raised. All such dividends were raised in good faith in line with their belief that the Appellant and Ms Hamilton were joint shareholders. All years' returns were amended in October 2012 to show that the Appellant and Ms Hamilton owned one share each.

The Appellant has received legal advice suggesting that Ms Hamilton may have had a beneficial interest in the share(s) or that a share was held on trust for her by implication equitable assignment or under a constructive trust. However there was no formal Declaration of Trust or other documentary evidence of the Appellant's express intention to vest or hold a share in trust for Ms Hamilton. The Appellant alternatively argues that if Ms Hamilton had no share interest in the company then the dividend was in any event an unlawful payment by the company.

HMRC argued that Mr Raine had not provided any evidence to show that he and Ms Hamilton intended to each hold 50% of the shares in Linkdrive Solutions Ltd or that there was any significant detriment to Ms Hamilton. This ignores the statements given by the deceased partner.

Unlike criminal law which requires the judgement to be guilty beyond reasonable doubt, the assessment of tax requires a civil standard of proof which is based on the balance of probabilities. The facts show that what was intended and what happened were different and HMRC were right to assess the additional tax on Mr Raine. But penalties are a different matter and it is arguable that HMRC must show that Mr. Raine was negligent and careless beyond reasonable doubt. It seems to me that this was a mistake created from things not being done properly and Mr Raine not understanding and not reading properly the forms which he was signing.

Technically, HMRC were right to assess the tax, morally it seems to me they were wrong to seek a penalty and the tribunal decision which is not a precedent but could be persuasive was wrong to confirm the penalty assessment. This was a mistake but HMRC are likely to cite this decision as indicative of the standard of care expected from a company director when signing tax forms.

One has to be pragmatic in tax. The cost of appealing the penalty determination which totals £5417.41 would be far greater than the penalty involved. That is monetary cost and what should never be forgotten is the stress and time caused to the appellant. HMRC should be ashamed of this result but I hope that Mr Raine's advisers do the decent thing and compensate him for the numerous mistakes which apparently occurred.

http://www.financeandtaxtribunals.gov.uk/judgmentfiles/j9181/TC05201.pdf

3. Footballer's Mistake gets penalty

Denmark has been able to prepopulate tax returns since 1986. Indeed many countries prepopulate returns and merely ask the taxpayer to check that the return is correct. The UK operates a different system which imposes cost and worry on taxpayers who have to prepare their own return and submit this to the fiscal authorities. Employees know that HMRC are notified of their pay and tax and can check the figures which they insert into the return so it is fairly obvious that omitting a source of employment income is a mistake.

The principle underlying the introduction of the penalty regime found in Schedule 24 FA 2007 was that mistakes would not be penalised and a penalty would not be charged if the taxpayer had a reasonable excuse. A penalty could also be suspended if the taxpayer took positive steps to prevent a recurrence. But avoidable mistakes denotes a lack of care and if discovered by HMRC will face a penalty of between 15% and 30% depending on the mitigation discretion given by HMRC.

In Nicholas Blackman –v- R&C [2016] UKFTT 0465, a footballer who had played for three different teams in 2012/13 omitted the income from the first of the teams from his tax return. It seems that he had been let down by his previous accountants and not only was his return late (April 2014) but also his income from Blackburn Rovers was omitted.

This is not a case in which any dishonesty has ever been alleged against Mr Blackman, his mother, or his previous advisers. The allegation is of an honest, but careless, mistake. HMRC imposed a penalty of 15% of the tax lost which they calculated was £1,141.87. HMRC's arguments were these:
(1) The responsibility for checking his self-assessment return lay with Mr Blackman;
(2) The inaccuracy was a careless one, assessed according to an objective standard.

Cases cited in argument included:
Hanson v HMRC [2012[UKFTT 314
Nigel Barrett v HMRC [2015] UKFTT 0329
David Testa v HMRC [2013] UKFTT 151
Anthony Fane v HMRC [2011] UKFTT 210

Mr Blackman did not attend and as a result there was no admissible evidence that he had not in fact understood his tax return. Even if Mr Blackman may have been let down by his previous accountants, Mr Blackman is the taxpayer, and it is his conduct which the tribunal must assess. Mr Blackman cannot possibly have forgotten, or not known, when authorising the filing of his tax return in April 2014, that he had been transferred twice, and hence had been employed by three clubs, between April 2012 and April 2013. The tribunal ruled that he had failed to take reasonable care in checking his return before he authorised its submission. The penalty was confirmed.

The tribunal also considered whether HMRC should have exercised discretion and suspended the penalty. In the absence of any evidence - whether from the appellant, his mother, or his previous accountants - as to how the error specifically came to be made in the first place, the tribunal simply do not know and therefore cannot assess (and nor, had it been raised earlier, could HMRC have assessed) how the condition proposed in fact relates to what had already happened in relation to the tax return. The conditions necessary to suspend a penalty were not met and so the penalty stood. I think that both these cases are evidence that HMRC are seeking penalties more aggressively. Both decisions show that a taxpayer cannot use an excuse that the taxpayer relied on the work done by an adviser but remember these decisions are not legal precedent and not legally binding.

http://www.bailii.org/uk/cases/UKFTT/TC/2016/TC05218.html

4. Sporting Events – limited income tax exemption

A limited exemption from income tax is available to people who compete or are involved in supporting the games (see reg 4) from 2 days before to 2 days after the London Anniversary games which were held on 22 and 23 July 2016.

A statutory instrument SI 2016/771 gives details and can be found at : (http://www.legislation.gov.uk/uksi/2016/771/made)

This SI also gives details of an income tax exemption which will be available in 2017 for the World Athletics championship as defined below:

1. “World Athletics Championships” means these events—

2. (i)the International Paralympic Committee Athletics World Championships event planned to be held at the Queen Elizabeth Olympic Park in London from 14th to 23rd July 2017 inclusive; and

3. (ii)the International Association of Athletics Federations World Championships event planned to be held at the Queen Elizabeth Olympic Park in London from 4th to 13th August 2017 inclusive.

To those qualifying for the exemption it will be available from 2 days before the first event to 2 days after the second event

5. Relying on avoidance scheme advisers is not negligence

In Bayliss v Revenue and Customs [2016] UKFTT 500, the taxpayer had used an avoidance scheme which did not work to claim a capital loss of £539,000 to be set against his real capital gains. His self assessments for two years 2006/7 and 2007/08 were incorrect and HMRC sought a 35% penalty accusing Mr Bayliss of negligence under the old penalty regime (s95(1) TMA 970).

1. The Failed scheme involved the purchase by the appellant of a contract for difference (“CFD”) from Pendulum Investment Corporation (“Pendulum”), a company based in the Seychelles. The CFD had a maximum life of ten years from the start date and was linked to the FTSE 100 index. It was split into four phases with different target index levels at the ends of years 3, 5, 7 and 10. These levels were 9,690, 12,160, 14,180 and 16,890 respectively. If the relevant target index level was met Pendulum would pay out a specified percentage of the issue value, ranging from 150% at year 3 to 550% at year 10. The start date was 13 February 2007.

2. An initial margin of 6% was payable. This was £51,000, which the appellant was required to invest from his own funds. The total issue value was £850,000. The balance of £799,000 (referred to as the “margin balance”) was payable within 14 business days of the start date. This amount was to be funded by a loan from an Isle of Man company associated

with Pendulum, Bayridge Investments LLC ("Bayridge"). The loan was interest free and for a period of 80 years. However, fees were payable to Bayridge if a profit was made from the CFD, and the loan also had to be repaid if fees were due. The fees were calculated as a percentage of the profit, being 30% for the first 3 years, 50% for the following 4 years and 75% after 7 years.

3. The terms of the CFD also permitted the appellant to require Pendulum to make a written offer to repurchase all or part of the CFD at any time. The appellant exercised this right before the end of the tax year and disposed of 65% of the CFD, for which he received £11,000.

Yes. I think this is complex and convoluted and the average taxpayer would have to rely on his advisers. There cannot be negligence if someone makes a mistake in interpreting complex legislation and in my view HMRC were totally wrong to allege negligence or even fraud.

The part disposal of the CFD was claimed to give rise to a loss of £539,000, being the difference between the £11,000 received and £550,000, which is in the region of 65% of £850,000 (the reason for it being slightly different was not explained).

The appellant's original career was as a teacher. He started a property business in the early 1990s, purchasing residential properties, refurbishing them and letting them to students. He left the teaching profession in 1996 to concentrate on the business. He clearly had some success, and wrote a book about building a property portfolio which was published in 2006. On some occasions he took out loans to finance the business, secured by mortgages. He had no experience of the stock market and accepted in evidence that he did not know what a CFD was. Despite this he signed a declaration that he was a sophisticated investor in relation to CFDs.

His tax adviser explained that there was a "tax loophole" under which a loss could be created to offset the gains. The tribunal accepted the appellant's evidence that he understood this to mean a flaw in the tax rules that allowed less tax to be paid, and that he was assured that the arrangement was legal.

The scheme failed and the tax was due. The good news is that the tribunal ruled that the taxpayer had not been negligent. He relied on advisers who promoted a scheme which did not work but he had acted in a reasonable manner and it was reasonable to rely on the advice given. So no penalty was imposed.

http://www.bailii.org/uk/cases/UKFTT/TC/2016/TC05251.html

Are there lessons to be learnt from the cases which I have summarised today? The most obvious one is that HMRC now seek penalties more aggressively. The second is that if a taxpayer tries to avoid tax by using a scheme that taxpayer needs to be very careful to get the documentation perfect and to check that the scheme will work HMRC have published a list of schemes which fail at https://www.gov.uk/government/publications/tax-avoidance-litigation-decisions/tax-avoidance-litigation-decisions-2015-to-2016

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31 July 2016

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

There will be a general tax podcast updating AAT members on recent developments and decisions available on the website on 31 August 2016.