Smith & Williamson

Tax update

A round-up of recent issues

2 October 2018

1. General 1
1.1 Budget 2018 date announced 1
1.2 Welsh taxpayer guidance released 2
1.3 CIOT responds to HMRC's proposal to extend powers 2
2. Private client 2
2.1 FTT denies an equitable claim for Entrepreneurs' Relief 2
2.2 Restriction on private residence relief (PRR) for off-plan property purchase 3
2.3 CGT holdover relief allowed by UT 4
3. Business tax 4
3.1 Capital allowances claims fail for licence schemes 4
3.2 Proposed EU Digital Services Tax rate increases 5
4. VAT 5
4.1 Alternative Dispute Resolution agreement amounts to a contract 5
4.2 No reduced VAT rate for components supplied as part of a single supply 6
5. And finally 6
5.1 Mending the guttering 6

1. General

1.1 Budget 2018 date announced

The 2018 UK Budget will take place on 29 October 2018.

The Chancellor of the Exchequer has announced that the UK Budget will take place on Monday 29 October 2019. This follows his decision to decline to set the Budget date at the annual session of the House of Lords Economic Affairs Committee just three weeks ago. The Office of Budget Responsibility is typically given 10 weeks' notice of the Budget date, but this can be waived in exceptional circumstances. The Chancellor has not commented on why the normal notice period has not been given, but the Treasury has stated that the earlier date is to allow Parliament more time to debate before the recess on 6 November.

This will be the first time a Budget date has been set on a Monday since 1962.

www.parliament.uk/about/how/role/check-and-approve-government-spending-and-taxation/the-budget-and-parliament/

1.2 Welsh taxpayer guidance released

Technical guidance on Welsh taxpayer status has been published by HMRC, setting out HMRC's policy for determining who is a Welsh taxpayer.

HMRC has published a new technical manual on Welsh taxpayers in advance of the introduction of Welsh taxes on 6 April 2019. The manual sets out HMRC's policy on who is a Welsh taxpayer and the tests for a close connection with Wales. The list of factors HMRC will consider when determining if an individual's main place of residence is in Wales is also included. This is broadly in line with the equivalent list for private residence relief for CGT.

A Welsh taxpayer will be someone who:

- is a Welsh Parliamentarian;
- has a 'close connection' to Wales because of having the main or only place of residence in Wales; or
- spends more days in Wales during the year than in any other part of the UK.

www.gov.uk/hmrc-internal-manuals/welsh-taxpayer-technical-guidance

1.3 CIOT responds to HMRC's proposal to extend powers

The CIOT has expressed concern that the proposed expansion of HMRC's information gathering powers is too wide. It has put forward an alternative approach and emphasised the need for taxpayers' rights to be protected.

The CIOT has published its response to the consultation on the expansion of HMRC's civil information powers. The proposed changes would allow HMRC to obtain information on taxpayers from third parties without first obtaining Tribunal approval. The CIOT has expressed concern that both of the proposed approaches will give HMRC too much power without proper safeguards for taxpayers. HMRC has stated that the driving force behind the consultation is the increased number of requests from international jurisdictions, primarily for banking information. In its response, the CIOT noted that the proposals go beyond the power needed to make these information exchanges. It has provided an alternative option, which would allow HMRC to make information requests from third parties without Tribunal oversight only after approaching the taxpayer. Whichever option is chosen, the CIOT believes that HMRC should in every circumstance be obliged by statute to request the information from the taxpayer before approaching a third party.

www.tax.org.uk/sites/default/files/180925%20Amending%20HMRC%27s%20Civil%20Information%20Powers%20-%20CIOT%20comments.pdf

2. Private client

2.1 FTT denies an equitable claim for Entrepreneurs' Relief

The FTT has denied a claim for Entrepreneurs' Relief made on the basis that under equity a contract should be treated as having been carried out. The Judge found that a contract did not exist, but, anyway, the shares lacked the necessary rights to qualify for the relief.

The taxpayer was the chief executive of a healthcare business. He realised a significant gain on his shares when the company was taken over. Although he held more than the required 5% of the share capital, his shares did not carry voting rights and so failed to qualify for Entrepreneurs' Relief (ER). Prior to the sale, he had agreed with the Chairman of the Board of Directors that his shares would be enfranchised and given voting rights, precisely because they would otherwise fail to qualify for ER when the business was eventually sold. At that time, they had intended to sell the business after 2 years. The Chairman took an excessively long time to arrange the variation of the share rights, and the takeover offer arose

unexpectedly. As a result, the taxpayer had not held the enfranchised shares for the requisite 12 months before the disposal. He was thus disqualified from ER.

The taxpayer argued that the enfranchisement agreement was a specifically enforceable contract Under the principles of equity, he argued such contracts are treated as if they have been carried out. The voting rights should therefore be treated as having been acquired more than 12 months before the takeover. The FTT considered the facts carefully and concluded that the agreement was not legally binding because it lacked certainty, intention to create legal relations and exchange of good consideration. The appeal therefore failed and ER was denied. In any event, however, the voting rights would have derived from the contract and not from the shares themselves. This meant that the voting rights were not buy virtue of the shareholding and accordingly would not have ranked for ER purposes.

Dieno George v HMRC [2018] UKFTT 0509 (TC)

http://financeandtax.decisions.tribunals.gov.uk/judgmentfiles/j10646/TC06678.pdf

2.2 Restriction on private residence relief (PRR) for off-plan property purchase

The UT has overturned an FTT decision, finding in HMRC's favour that the period of ownership for PRR purposes is the period between exchange of contracts for purchase and for sale.

The taxpayer entered into an 'off-plan' contract in October 2006 for the lease of a flat under construction, with a right to rescind the contract if the property was not completed before June 2012. He was also entitled to sub-sell the flat once the final deposit had been paid in March 2007.

Work began in 2009 to construct the apartment and it was physically completed in December 2009. Legal completion took place on 5 January 2010, the date Mr Higgins first became entitled to occupy the property. He then occupied it as his main residence until it was sold two years later. It was agreed as a matter of fact that there was no other dwelling that the taxpayer regarded as his main residence throughout the period July 2007 to January 2010.

The FTT had found that a period of ownership cannot begin before the taxpayer has a legal title to the property and a legal right of occupation. The UT has now overturned this decision, instead finding that the relevant period of ownership is the period between exchanges of contracts and therefore started with the original contract to purchase. It found that this construction is consistent with the Parliamentary intention of restricting relief where a dwelling has not been a main residence throughout the period during which the gain arises.

The taxpayer also raised an alternative argument, being that initially he was not occupying any part of the apartment and once the building work was complete he was occupying the entire apartment. As there had been a change in what was occupied as the taxpayer's residence, a just and reasonable approach should be considered. The UT found no merit in this argument.

This decision raises concern as to whether or not a portion of the gain arising on the disposal of a main residence, that is not covered by HMRC's published concession (ESC D49), should be subject to CGT where there is a short period between exchange and completion. The case does consider this point and notes that this difficulty is dealt with by '*HMRC's practice whereby they ignore a period of a few weeks' non-residence that often occurs on the purchase of a dwelling house between exchange of contracts and completion*.' This practice however is not published and this decision does leave uncertainty as to what length of delay between exchange of contracts and completion will fall within that HMRC practice.

Higgins v HMRC [2018] UKUT 0280 (TCC)

https://assets.publishing.service.gov.uk/media/5bab515ae5274a54d2ef7bc2/HMRC_v_Desmond_Higgins.pdf

2.3 CGT holdover relief allowed by UT

The UT has found that a non-resident taxpayer could claim holdover relief on the gain arising when he gifted his interest in an LLP to a UK company that he wholly owned. The FTT had found that having a non-resident spouse and children caused the claim for holdover relief to fail.

The taxpayer, a US citizen, was resident in the UK when he co-founded a hedge fund business using an LLP. He left the UK in 2007 and the LLP began planning to move its business out of the UK two years later. He gifted his interest in the LLP to a UK resident company of which he was the sole shareholder and director before the LLP emigrated. This meant that a CGT charge did not arise on emigration of the LLP under deeming provisions. He claimed holdover relief, deferring CGT of just over £33m. He subsequently sold his shares in the company in 2011, and paid CGT in the US at just under 23% on the gain arising. HMRC claimed that holdover relief was not available and the FTT agreed with this.

Both the taxpayer and HMRC agreed that the legislation was flawed when read literally, but disagreed as to what a purposive interpretation should be. Based on a literal interpretation, the legislation suggests that holdover relief is denied where the transferee is a company owned by the transferor if he has a non-resident spouse or children despite them having no shareholding in the company. Where there were no such non-resident relatives, holdover relief would be allowed.

The UT found that the HMRC could not extend a provision designed to close one gap to close a different gap that Parliament had not even considered.

It also found that it cannot have been Parliament's intention that holdover relief should be withheld merely because there is someone who is connected to the transferor and is non-resident even if they have no interest in the transferee company. It held that the context of the legislation requires an artificial assumption to be made that control can only occur by virtue of holding assets.

Accordingly, holdover relief was allowed.

Reeves v HMRC [2018] UKUT 0293 (TCC)

https://assets.publishing.service.gov.uk/media/5bab4f33e5274a54b6245458/William_Reeves_v_HMRC.pdf

3. Business tax

3.1 Capital allowances claims fail for licence schemes

The closure notices denying capital allowances for two LLPs were upheld on the grounds that the LLPs were not trading at the time the expenditure was incurred. The LLPs were not however found to be avoiding tax, since they did not have profits against which to offset the capital allowances had the claims been allowed.

The taxpayers were two LLPs with the same managing partner that had entered into convoluted arrangements to acquire software licences and generate significant losses. The arrangements involved loan facilities, offshore guarantors and warranty payments to ensure prospective members would receive a return at least in line with the interest rate. The loss positions were created primarily through claims for first year capital allowances on the acquisition of the licences. These claims were made under law which has since been repealed. HMRC inquired into the LLPs and issued closure notices reducing the aggregate losses of approximately £43m to nil.

The first issue before the FTT was whether or not the LLPs had been trading at the time the software licences were acquired. It was found that the taxpayers could not provide evidence of trading or of any trading in subsequent periods. Second, it was held that only the initial payments made were in fact 'expenditure' on the licences; the remaining amounts were complicated loan arrangements that did not amount to meaningful expenditure on the licences. The third finding was that, under the law in force at the time, an LLP could not be a small or medium enterprise for the purposes of capital allowances because only bodies subject to CT satisfied the statutory definition.

Although the appeal had failed, the Judge considered the issue of anti-avoidance for completeness. It was held that capital allowances could not be of value to an LLP that did not have profits against which to offset them or the prospect of future profits. Furthermore, the scope of the anti-avoidance provision does not encompass the benefit the capital allowances might have to members of the LLP. There was therefore no anti-avoidance in point despite the fact that the availability of capital allowances was a major factor for those implementing and investing in the LLP.

Daarasp LLP & Another v HMRC [2018] UKFTT 0548 (TC)

http://financeandtax.decisions.tribunals.gov.uk/judgmentfiles/j10679/TC06718.pdf

3.2 Proposed EU Digital Services Tax rate increases

The proposed EU Digital Services Tax has been amended and the tax rate increased from 3% to 5%. The scope of the tax has also been widened.

The Committee on Economic and Monetary Affairs (ECON) has drafted amendments to the proposed EU Digital Services Tax (DST) on the turnover of digital service providers. The proposed tax rate has increased from 3% to 5% to create a more level playing field with traditional businesses. The scope of DST has also been widened to include the supply of digital content such as video, audio or text and the sale of goods or services on e-commerce platforms. ECON has reaffirmed that DST is intended to be temporary by inserting a sunset clause so that the measure will lapse once proposals for a digital significant presence or permanent establishment are adopted.

The EC currently intends for DST to be implemented by Member States by 1 January 2020. It is not yet clear if the UK will adopt the measure; having initially supported it, the UK opposed the proposal when it was put forward for consideration in March.

www.europarl.europa.eu/sides/getDoc.do?type=COMPARL&reference=PE-627.911&format=PDF&language=EN&secondRef=01

4. VAT

4.1 Alternative Dispute Resolution agreement amounts to a contract

The FTT has found that an agreement made during an Alternative Dispute Resolution process amounted to an enforceable contract to the extent that it was not ultra vires.

The taxpayer, a charity that operated two art galleries, had made an agreement with HMRC regarding the VAT treatment of future payments received from supporter schemes. The taxpayer received donations from supporters, who were then eligible for special benefits. This raised the issue of whether or not the payments, comprised of donations and payments for benefits, were a single standard rated supply. The agreement on future treatments had been made during an Alternative Dispute Resolution (ADR) process, but the parties had failed to agree on the treatment of past scheme receipts. The matter was taken to the FTT, which made a ruling on the past payments. In her decision, the Judge commented that the agreement in respect of the future VAT treatment was contrary both to law and to HMRC's published policy. HMRC subsequently wrote to the taxpayer, explaining that it had not intended to make an agreement opposed to its own policy and set out a position in line with VAT law. An assessment was made in respect of the VAT that had arisen since the ADR and had been treated in line with the original agreement.

The taxpayer appealed against this assessment on the grounds that the agreement reached in the ADR process was binding. The FTT found that the agreement was a legally binding contract because the parties did have intention to create legal relations during the ADR process. Furthermore, the contract was not void by reason of unilateral mistake by HMRC because the taxpayer had no real reason to suppose the existence of a mistake. It was however void on the basis that HMRC does not have the power to enter into a contract that is wrong as a matter of law. Therefore, HMRC was allowed to change its position and the revised assessment was upheld. The only way the charity can now challenge HMRC's change of position is by a judicial review action on the ground of legitimate expectation.

The Serpentine Trust Limited v HMRC [2018] UKFTT 535 (TC)

www.bailii.org/uk/cases/UKFTT/TC/2018/TC06719.html

4.2 No reduced VAT rate for components supplied as part of a single supply

The UT upheld the FTT's decision that the supply of energy saving materials together with the installation of a boiler or other central heating products is a single supply subject to a single rate of VAT at the standard rate.

The taxpayer had made supplies of installing boilers and central heating systems in residential accommodation. Reduced rate VAT had been applied to those elements of its supplies that were energy saving materials regardless of whether they were elements of a single composite supply. The taxpayer did accept that the standard rate applied to the remaining components. The FTT considered the case law on single supplies including elements that would be subject to different VAT rates if supplied separately and dismissed the appeal. The UT upheld this decision on appeal.

An Checker Heating & Service Engineers v HMRC [2018] UKUT 0292 (TCC)

https://assets.publishing.service.gov.uk/media/5ba398dde5274a54b62453fa/AN_Checker_v_HMRC_FINAL_FOR_RELEASE.pdf

5. And finally

5.1 Mending the guttering

He jests at scars that never felt a wound. It seems the standard of our reporting fell to a new low a couple of weeks ago. Yes; just two weeks ago we confidently reported: '*Philip Hammond has declined to set a date for the 2018 Autumn Budget, stating that he wishes to prevent a clash between the Budget and the EU Summit in November where a Brexit deal may be agreed.*' While what we said here was strictly true, we clearly failed to consider the exact meaning of the words and we inferred entirely incorrectly that this meant the Budget was being postponed. More fool us. It is scant comfort that we were not alone in misinterpreting this. The Chancellor would argue that he had not changed his mind in setting a date early if his intention was to avoid a clash of diaries. Nor was it remotely reasonable on our part to assume he wouldn't choose university reading week and that making tax people cancel those little holiday breaks would even make him pause; though, if it had, that would indeed have been reasonable.

We do wonder, though, what the view of the Office of Budget Responsibility's (OBR) views on this are. As mentioned above, the Memorandum between the OBR and the Treasury states '*In the absence of exceptional circumstances, the Chancellor will give the OBR at least 10 weeks' notice of the chosen date [of the Budget].'* Let's hope OBR sleeves were rolled up and no heads were let drop, not to mention any leave cancelled. Let's hope too that they don't read the unreliable gutter press. Unlike you.

Sorry.

http://obr.uk/docs/dlm_uploads/MoU_2017_updateWebPDF.pdf

Glossary

Organisations		***Courts***	***Taxes etc***	
ATT – Association of Tax Technicians	ICAEW - The Institute of Chartered Accountants in England and Wales	CA – Court of Appeal	ATED – Annual Tax on Enveloped Dwellings	NIC – National Insurance Contribution
CIOT – Chartered Institute of Taxation	ICAS - The Institute of Chartered Accountants of Scotland	CJEU - Court of Justice of the European Union	CGT – Capital Gains Tax	PAYE – Pay As You Earn
EU – European Union	OECD - Organisation for Economic Co-operation and Development	FTT – First-tier Tribunal	CT – Corporation Tax	R&D – Research & Development
EC – European Commission	OTS – Office of Tax Simplification	HC – High Court	IHT – Inheritance Tax	SDLT – Stamp Duty Land Tax
HMRC – HM Revenue & Customs		SC – Supreme Court	IT – Income Tax	VAT – Value Added Tax
HMT – HM Treasury		UT – Upper Tribunal		

smithandwilliamson.com

Offices: London, Belfast, Birmingham, Bristol, Cheltenham, Dublin (City and Sandyford), Glasgow, Guildford, Jersey, Salisbury and Southampton.

Smith & Williamson LLP: Regulated by the Institute of Chartered Accountants in England and Wales for a range of investment business activities. A member of Nexia International. The word partner is used to refer to a member of Smith & Williamson LLP.

A member of Nexia International
Smith & Williamson is a member of Nexia International,
a worldwide network of independent accounting and consulting firms.