Smith & Williamson

Tax update

A round-up of recent issues

30 April 2019

1. General

1.1 Tax update and the early May Bank Holiday

Tax update will be taking a break next week. The next issue will be on 14 May.

1.2 Government calls for evidence on Social Investment Tax Relief

The Government would like to hear evidence on the use of Social Investment Tax Relief (SITR), prior to a decision on the future of this relief, which is used less than was anticipated at its introduction.

SITR gives IT and CGT relief on investments in social enterprises, on similar terms to those for investments in small trading companies. It is designed to combat the difficulties social enterprises have in obtaining funding when compared to trading companies eligible for other investment tax reliefs. This call for evidence is in line with the commitment to review stated when the scope of SITR was expanded two years ago. If not renewed, the relief ends automatically in 2021.

The relief has been used less than was anticipated; so, in order to take a decision about the future of this relief, the Government would like to hear from those who have claimed the relief, social enterprises that have obtained funding under this scheme, and enterprises who have not, with their reasons for not taking up the scheme.

www.gov.uk/government/consultations/social-investment-tax-relief-call-for-evidence/social-investment-tax-relief-call-for-evidence

2. Private client

2.1 FTT directs HMRC to issue partial closure notice regarding domicile

A taxpayer requested a partial closure notice, which was introduced in 2017, so that he could appeal the question of his domicile before the potential tax was determined. The FTT directed that HMRC should issue this before it had finished its investigation, and considered the purposes for which partial closure notices were introduced.

HMRC enquired into two tax returns, and determined that the taxpayer was UK domiciled. It issued an information notice requiring details of his overseas income and gains for the years in question. The taxpayer refused to comply with the notice before he had been able to appeal the determination of his domicile. HMRC refused to issue a closure notice, which he would need in order to appeal, before the quantity of tax due had been determined, and for which it needed the documents it had requested.

The taxpayer applied to the FTT to request a partial closure notice, a concept introduced in FA2017, on the question of his domicile. HMRC argued that the principle should not be divided from the tax determination, and that the enquiry should be looked at as into the remittance basis claim, rather than the domicile and tax due questions separately, as they were inextricably linked.

The FTT ordered HMRC to issue the partial closure notice, as it decided that this could be issued without an assessment of the tax due, and that HMRC had not shown reasonable grounds for not issuing the notice. HMRC must now decide whether or not to litigate the domicile question without an estimate of how much tax is at stake.

Embiricos v HMRC [2019] UKFTT 236 (TC)

www.bailii.org/uk/cases/UKFTT/TC/2019/TC07083.html

2.2 Discovery found to be 'stale' in residence case

The FTT has found that a discovery assessment raised by HMRC was not valid, saving the taxpayer £84m. A discovery was found to have been made, but the delay in issuing an assessment made it invalid.

The taxpayer left the UK for Monaco in March 2000, prior to a disposal of shares at a large gain in May 2000, and notified HMRC of his departure. Had he been resident in the UK in 2000/01, the CGT due would have been £84m. He filed a return with no reference to the disposal, and a white space note stating that he was non-resident, but prior to the hearing he accepted that he was in fact UK resident in 2000/01.

HMRC opened discussions with the taxpayer in 2003 following a newspaper article naming him as a 'tax exile', but did not issue an assessment until 2007 due to the time taken to gather the information

requested. It argued that the discovery was made as part of the information-gathering process. The FTT found that a discovery had been made, but that over three years had elapsed before an assessment was issued, so it was stale.

Hargreaves v HMRC [2019] UKFTT 244 (TC)

www.bailii.org/uk/cases/UKFTT/TC/2019/TC07090.html

2.3 FTT upholds surcharge on unauthorised withdrawal from a pension scheme

A taxpayer who withdrew funds from her pension via a loan scheme has been ordered to pay the unauthorised payment surcharge, as well as the surcharge, a total of 55% on the withdrawal. This was held to be 'just and reasonable' despite her genuine belief that the scheme was compliant and the subsequent collapse of the company holding her pension.

The taxpayer transferred £51,000 from her pension into a self-invested personal pension (SIPP), which invested in a company that made a 'loan' to the taxpayer of about half the funds. The scheme literature was on the basis that there would be no tax consequences, but she did not seek independent advice, and the scheme provider had become insolvent, resulting in the possible loss of the remaining funds. HMRC issued an assessment on the grounds that this loan was an unauthorised payment.

The taxpayer accepted the 40% charge applied by HMRC on the withdrawal, but appealed the 15% surcharge. She argued that it was neither just nor reasonable, as she had relied on assurances given by the loan providers and did not have funds to pay HMRC. The FTT upheld the surcharge, as although she believed that the scheme was compliant, this was not reasonable in the circumstances. She had taken no independent advice. HMRC removed the penalty (15% of the charges) prior to the hearing.

Franklin v Revenue & Customs [2019] UKFTT 232 (TC)

www.bailii.org/uk/cases/UKFTT/TC/2019/TC07079.html

2.4 FTT determines technical point on calculation of top slicing relief

The FTT has found that HMRC's methodology in a top slicing relief calculation was incorrect, reducing the tax assessment by over £22,000.

The taxpayer had failed to declare a chargeable event gain, as she believed that no tax was due. It was common ground that the amount was sufficient to reduce her personal allowance to nil. HMRC's calculation of top slicing relief, where tax is calculated as if income had been spread over the years the bond was held, therefore did not include the personal allowance. The taxpayer argued that the additional income would not have resulted in a reduced personal allowance when spread over the 21 years held, so the full amount should be included in the hypothetical calculation.

The FTT held that top slicing relief was intended to grant relief to persons who have taken income over a number of years when tax is charged in just one year. The only reason the taxpayer had lost her personal allowance was due to the chargeable event gain increasing her income in that year. The appeal was substantially allowed.

Silver v HMRC [2019] UKFTT 263 (TC)

www.bailii.org/uk/cases/UKFTT/TC/2019/TC07103.html

2.5 IT assessments dismissed on a sham tenancy agreement

A tenancy agreement between siblings involving complex family matters has been found by the FTT to be a sham. Whilst some of HMRC's discovery assessments of IT on rental profits were validly made, they were based on false information and therefore cancelled.

The taxpayer had acquired a property from one of his sisters on behalf of another sister, because she was unable to obtain a mortgage. She later acquired the property from the taxpayer, partly as a gift and partly under a mortgage. The sister for whom he purchased the property was going through a divorce initiated by her husband, and her husband was also the brother of the taxpayer's wife. The taxpayer and his sister

were also first cousins of their spouses; the taxpayer's parents were both a sibling of a parent of his spouse. His family pressured him into divorcing his wife in response to his sister's divorce, and the FTT found as a fact that his family had pressured him into purchasing the property for her. The domestic stresses then escalated further, involving a family death, a house fire and an arrest. Amid this confusion, HMRC was notified by a local council that the taxpayer had been receiving payments of his sister's housing benefit as rental payments. HMRC raised IT assessments on him for rental income.

The FTT found that the notification from the local council was 'wholly misguided and misleading'. HMRC, however, was not in a positon to know this, and had acted reasonably on the information in relation to some of the tax years in question. It was not reasonable for HMRC to rely on the presumption of continuity in relation to later tax years, because the benefit is means-tested and likely to change. The assessments for the earlier years, though valid, were not ultimately upheld by the FTT because the tenancy agreement was found to be a sham. The taxpayer's family had deceived the council into granting the sister a housing benefit, for which a tenancy agreement was required. The house was in fact owned by his sister, and the taxpayer had signed the agreement without knowing what it was. Since the agreement was a sham, the taxpayer was not entitled to rent and so could not be liable to tax on rental income.

Mohammed Kamran v HMRC [2019] UKFTT 0257 (TC)

www.bailii.org/uk/cases/UKFTT/TC/2019/TC07097.html

2.6 FTT urges HMRC to reduce a penalty imposed over a turbulent pregnancy

The taxpayer had lost an appeal against a penalty for late payment of tax. That decision was appealed on the basis of new information: she had been delayed from paying her tax by complications when giving birth. The FTT found that it did not have the power to reverse its decision based on this new evidence but urged HMRC to reduce the penalty under its powers.

The taxpayer had lost an appeal against late filing penalties in a default paper case; that is, a case not heard in person. The FTT had found that she had a reasonable excuse for late payment, but had failed to pay within a reasonable time after that excuse ceased. The taxpayer appealed this decision on two grounds: the FTT was incorrect to calculate the delay as more than three months, and the FTT was not made aware that the taxpayer's baby, who was born during this time, suffered from a serious heart defect. This information had not been included in the original submissions to the FTT because HMRC's case had been that there was no reasonable excuse. The birth complications related to the period after that excuse had ceased and was not anticipated to be relevant. HMRC took the position that it was not in the interests of justice to set aside the decision as all the procedural requirements had been properly followed.

The FTT reluctantly found that it could not reverse its decision. Since there had been no failure to follow correct procedures, it could not set the decision aside on that basis. The judge admitted that he had made an error of law in relying too heavily on a threshold of three months as signifying a significant delay. He would not, however, be able to take the new evidence into account if he reconsidered the case. Reviewing the decision would therefore not change the outcome. The judge unequivocally stated that if the details of the birth had been available he would have found in her favour. HMRC was urged to reduce the penalty under its powers to amend penalties in special circumstances.

Sabira Gulamhussein v HMRC [2019] UKFTT 0261 (TC)

www.bailii.org/uk/cases/UKFTT/TC/2019/TC07101.html

2.7 FTT largely upholds 'best judgment' assessments made by HMRC

HMRC made estimated assessments due to the failure of the taxpayer to comply with an information notice. The FTT largely upheld these despite the lack of basis for them, except where the taxpayer had supplied clear evidence to counter them.

The taxpayer had failed to declare rental income from his property business for some years, and the gain on sale of one property. Instead of complying with an information notice from HMRC, his accountant made a subject access request to HMRC under the Data Protection Act requesting details of the mortgages,

interest payable, and SDLT forms. HMRC responded by issuing assessments for IT and CGT based on their estimates of market rent and expenses. The taxpayer appealed, but supplied limited evidence to counter the assessments.

The FTT found that, although the assessments must be inaccurate to some degree, that was an inherent part of the best judgment process. It upheld the assessments for the most part, with adjustments for mortgage interest and some unpaid rent as the taxpayer supplied the court with evidence of this. It rejected his claim for the wear and tear allowance of 10% as he had not claimed this within the time limits.

Vadamalay v HMRC [2019] UKFTT 241 (TC)

www.bailii.org/uk/cases/UKFTT/TC/2019/TC07087.html

3. PAYE and employment

3.1 Bill on NIC treatment of termination awards and sporting testimonials

A bill introduced to Parliament last week aims to align the NIC treatment of termination awards and sporting testimonials with their income tax treatment from April 2020.

In recent years, certain types of termination payments previously exempt from tax, and sporting testimonials, have become subject to income tax to the extent that they exceed set thresholds. The entirety of the payment is still exempt from NICs, so the Government now plans to align the NIC and IT treatment from April 2020. Under the proposed changes these termination payments will still be exempt from employee NICs, but employer NICs (currently 13.8%) will be charged on amounts over the £30,000 threshold. Employer NICs will be charged on sporting testimonials as an employee benefit over the £100,000 threshold.

www.gov.uk/government/publications/national-insurance-contributions-termination-awards-and-sporting-testimonials-bill/national-insurance-contributions-termination-awards-and-sporting-testimonials-bill

3.2 FTT limits deeming provision in an employment-related securities options case

A director had received share options from his employer for reasons other than his employment, but under a strict interpretation of the law the options were deemed to be employment-related securities options. The FTT found that the ambit of the deeming provision should be limited where the artificial assumption imposed by the statute is at variance with the facts of the case.

The taxpayer, a software company, had issued share options to an individual in consideration for an unpaid debt for supplying services. The individual was later appointed as a director of the company. After his appointment, the supplier share options were replaced by new share options as part of an attempt to rescue the company from bankruptcy. The FTT found that the replacement options were not issued by reason of his employment. HMRC, however, argued that on the basis of the deeming provision in ITEPA 2003 s.471(3) the share options must be treated as provided by reason of employment because they were issued by his employer.

The FTT examined the case law on statutory interpretation in detail and found that this was an unusual situation that would, on a strict reading, result in an absurd outcome. It held that the effect of the deeming provision should be limited to prevent imposing an assumption that was at odds with the facts of the case. Alternatively, it found that the grant of the replacement options could not realistically be viewed as made available by the company in its capacity as his 'employer', thus disapplying of the deeming provision. The replacement share options were therefore held not to be employment-related securities.

It did not consider the possible alternative of a notional loan for shares acquired at an undervalue from the employer and its subsequent write off on sale. It is, though, reasonable to infer that the court might

have come to the same conclusion about the deeming rules for employment-related securities that it did for employment-related securities options.

Vermilion Holdings Limited v HMRC [2019] UKFTT 0230 (TC)

www.bailii.org/uk/cases/UKFTT/TC/2019/TC07077.html

3.3 HMRC loses another TV personality contractor case

The FTT has found that television and radio presenter Kaye Adams was not an employee of the BBC in relation to contracts to present a morning radio show. Taken as a whole, the facts of her engagement with the BBC reflected her role as a contractor, and not part of the BBC organisation.

The intermediary, Kaye Adams' personal service company, appealed against determinations of IT and NICs made by HMRC in relation to payments under two contracts with the BBC. The parties agreed that the correct approach to determine the tax treatment was to construct a hypothetical contract between Ms Adams and the BBC, on the assumption that the services had been provided directly by her, not the intermediary. If that hypothetical contract was an employment contract, rather than a contract for services, the actual earnings would be characterised as employment income for tax purposes. The parties differed, however, in their opinion as to how such a hypothetical contract should be constructed.

The FTT found that the terms of the hypothetical contract between the BBC and Ms Adams should be regarded as being the terms of the actual agreement between the BBC and the intermediary. The 'actual agreement' was the agreement that in fact existed between the BBC and the intermediary, which was not necessarily the same as the written contract between them. On this basis, the hypothetical contract lacked the necessary control by the BBC over Ms Adams' activities outside her contractual work for it to be an employment contract. Additionally, there was not sufficient mutuality of obligation between the parties. The income from the BBC, when viewed in terms of her overall career, was of a small enough proportion to suggest that Ms Adams carried on her profession as an independent provider of services. She did not receive holiday pay, sick pay or maternity leave from the BBC, and she did not have access to the BBC's equipment or IT systems when working outside the studio. These factors suggested that Ms Adams was not treated as part of the BBC's organisation, and carried on business on her own account. The payments were therefore not treated as employment earnings for tax purposes.

Atholl House Productions Limited v HMRC [2019] UKFTT 0242 (TC)

www.bailii.org/uk/cases/UKFTT/TC/2019/TC07088.html

3.4 Late appeal allowed for 'ludicrous' HMRC assessments

The FTT allowed a late appeal against assessments of PAYE and NICs on a company. The lack of clarity in the communications from HMRC was held to be a reasonable excuse for the director's late appeal. The assessments were also found to be fundamentally flawed to the extent that it was in the interests of justice to allow the company the opportunity to make its case.

The company operated several beauty salons in local shopping centres, and had failed to respond to HMRC's requests for information. HMRC undertook six 'test purchases', sending six employees to various salons to purchase a treatment and observe the business operations. The taxpayer was then issued with assessments to PAYE and NICs relating to its employees. The director failed to appeal these assessments within 30 days, but later made an application for a late appeal.

The FTT acknowledged that the delay of over five months was significant. The director, however, was found to have acted reasonably for most of the period of delay: the communications from HMRC were unclear and ambiguous as to when an appeal was necessary, and he had repeatedly attempted to settle the dispute. Furthermore, the methodology HMRC used in calculating the assessments was found to be fundamentally flawed. The Judge described the estimated PAYE as 'ludicrous'. The errors included assuming that the salons were open 365 days per year, not properly taking into account the PAYE information HMRC already had for some employees, and assuming that all staff worked full time but that the salon was not their main employment so they were not given the benefit of the personal allowance. For the assessments to be correct, the company would have had to have generated £2.7m of additional

income over five years to cover its employment costs. The test purchases, however, had not revealed any evidence of sales suppression. The application to make a late appeal was allowed.

Angel Beauty Parlour Limited v HMRC [2019] UKFTT 0247 (TC)

www.bailii.org/uk/cases/UKFTT/TC/2019/TC07093.html

4. Business tax

4.1 HMRC plans to amend hybrid capital instruments legislation

HMRC has updated the technical note on hybrid capital instruments to notify taxpayers that it intends to widen the definition of a 'conversion event' in CTA 2009. This change will ensure that hybrid instruments that are essentially genuine debt instruments will fall within the coupon deductibility provisions.

The technical note sets out the Government's proposed legislation on commercial hybrid capital instruments and tax mismatches. These rules will replace the Regulatory Capital Securities Regulations 2013, and aim to ensure that hybrid capital instruments that are genuine debt instruments are deductible for tax purposes. Under the current definition of a 'conversion event', some instruments with takeover or change of control provisions do not qualify as hybrid capital instruments. They may, therefore, not be tax deductible despite being debt instruments. The proposed amendment will bring such instruments within the definition and apply retrospectively to allow tax deductibility from 1 January 2019.

The draft regulations are expected to be published for consultation before the final regulations are laid before the House of Commons by 31 December 2019.

www.gov.uk/government/publications/hybrid-capital-instruments-technical-note?utm_source=10567b01-2ee8-4bb2-95a4-5deaab395c1f&utm_medium=email&utm_campaign=govuk-notifications&utm_content=daily

4.2 Interest deductions relief denied in international corporate reorganisation

Debits relating to an intra-group debt have been disallowed by the FTT on the basis that the loan was for an unallowable purpose. The loan was taken out as the final step in a group reorganisation, the overall purpose of which was commercial. The final step, however, was found to have been taken for the sole purpose of achieving a tax advantage.

The taxpayer was a UK company that had been incorporated as part of a wider international group reconstruction exercise. It had acquired preference shares in its immediate US parent company in exchange for issuing a £140m promissory note. The parent company elected under US law for the taxpayer to be treated as a branch for US tax purposes. The interest paid by the taxpayer was therefore not taxable on its immediate parent, but was an expense under UK tax law. Clearance had been obtained from HMRC, confirming that the arbitrage rules in effect at the time would not be violated so long as the taxpayer disclaimed 25% of the interest expense. HMRC subsequently disallowed the full amount of the debit on the basis that the loan had been taken out for the purpose of obtaining a tax advantage. Under UK law, arrangements with the main or one of the main purposes of obtaining a tax advantage are for an unallowable purpose. As this anti-avoidance provision was outside the scope of the arbitrage clearance, HMRC was not prevented from making the disallowance.

The FTT found that the loan did give rise to a tax advantage because the debits generated a loss in the taxpayer that was surrendered to another group company. It also found that the securing of a tax advantage was the sole purpose of the loan. Although the overall reorganisation had a commercial purpose, that purpose had been achieved by the prior steps in the arrangement. The final step of taking out the loan was done to ensure that sufficient UK debits were created to offset the UK income that would arise under the first seven steps. The principal and interest on the promissory note were calculated to offset that income exactly. The spread received by the taxpayer between the dividends and the interest expense was a means of justifying the step, but not the driving force behind it. Since the entire debit expense related to the unallowable purpose, the debit was entirely disallowable. The appeal was denied.

Oxford Instruments 2013 Limited v HMRC [2019] UKFTT 0254 (TC)

www.bailii.org/uk/cases/UKFTT/TC/2019/TC07094.html

5. VAT

5.1 ICAEW confirms the VAT registration process

The ICAEW has confirmed the VAT registration process with HMRC following the mandated introduction of Making Tax Digital for VAT for most VAT-registered businesses.

The VAT registration process has not been changed following the widespread introduction of Making Tax Digital for VAT (MTD). Businesses with a taxable turnover of at least £85,000 that are also required to comply with the MTD requirements must therefore register twice: once for VAT and once for MTD. The VAT registration must be complete before a business can sign up for MTD. HMRC has indicated that it plans to combine the two processes in the future.

https://ion.icaew.com/taxfaculty/b/weblog/posts/new-vat-registrations-and-making-tax-digital

6. And finally

6.1 The world upside down

We were intrigued to read the report on the STEP website that the New Zealand Government has decided not to introduce CGT. Not only that, further in the report, it was confirmed that the Government had also ruled out inheritance tax. Well, big deal you might think. Neither tax collects any great amount in the UK. They are comparatively unimportant taxes that a government could do without, and clearly, in New Zealand, happily does do without.

And we could leave it there, except that's our livelihood. Ask any private client tax planner and you will gather that they spend their lives planning for the consequences of these two giants of the personal tax field. Imagine a life without them: a life in a beautiful gentle country with spectacular scenery, grand enough to invoke the world as it was before tax really got going; Middle Earth itself. Ghastly. No British personal tax planner could ever want to live there: there would be nothing to do.

www.step.org/news/new-zealand-government-rejects-capital-gains-tax-recommendations

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		