Smith & Williamson

Tax update

A round-up of recent issues

19 January 2022

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1. General

1.1 Understatement of profits found to be careless behaviour

The FTT has confirmed penalties and assessments issued by HMRC to taxpayers who had overclaimed expenses and made a loan to a participator. It did however reduce penalties from the

deliberate to careless level, based on its assessment that the taxpayer did not understand the principles of tax involved, so could not have acted deliberately.

HMRC opened enquiries into the returns of a taxpayer and the company of which she was director (the appellants). Due to a failure to provide information, various penalties were issued for failing to comply with information notices, and four years after the investigation started, closure notices and discovery assessments were issued on overclaimed expenses and loans to participators. These were adjusted when the appellants provided more information.

The FTT found that the majority of the closure notices and discovery assessments were valid. It also upheld the penalties, except that it reduced some to the careless level rather than deliberate, on the grounds that the taxpayer did not understand some of the basic principles of finance and tax, so could not have acted deliberately.

JT Quinns Ltd & Anor v HMRC[2021] UKFTT 454 (TC)

www.bailii.org/uk/cases/UKFTT/TC/2021/TC08338.html

2. Private client

2.1 Update on penalty grace period

Taxpayers who pay tax bills that include class 2 NIC after the 31 January deadline may lose access to contributory benefits, despite the penalty grace period.

HMRC has issued a clarification concerning the penalty grace period announcement. The key point is that, if taxpayers owe class 2 NICs, but pay their balancing payment after 31 January, this can affect their entitlement to contributory benefits. Although late payment penalties will not be applied until later, the penalty grace period does not provide an easement on this issue. HMRC recommends that affected taxpayers get in touch.

www.tax.org.uk/self-assessment-penalties-further-update

2.2 Partners' legal fees on criminal charge found to be partnership expense

The FTT has allowed a partnership to claim deductions for the expenses of defending partners in criminal cases. It was shown that the business would have suffered significant ill effects from a conviction, so the expenses were wholly and exclusively for the trade.

Two partners in a partnership trading in scrap metal faced criminal charges over dealing in stolen property. They were ultimately found not guilty, but incurred substantial legal fees defending their case. HMRC disallowed these costs in the partnership tax returns on the grounds that they were not wholly and exclusively for the benefit of the trade, but also for the purpose of defending the partners' reputations and avoiding prison sentences for them. The taxpayer contended that the scrap metal industry is highly regulated, and the partnership would have been unlikely to obtain a licence if the partners were convicted. The landlord of the premises had also informed them that the lease would be terminated if they were convicted, and their bank and insurer could have also raised issues.

The FTT found for the taxpayer. It disagreed with HMRC's stance that the business would not have been significantly impacted by conviction. In addition, the partners were at risk of fines, rather than prison, and the damage to their personal reputations was done when their arrests were reported in the local news, rather than during the court process. The legal expenses were incurred wholly and exclusively for the trade, so allowable.

TR, SP AND SR Rogers v HMRC [2021] UKFTT 458 (TC)

www.bailii.org/uk/cases/UKFTT/TC/2021/TC08342.html

2.3 Taxpayer loses appeal on domicile partial closure notices

The CA has agreed with the UT that partial closure notices (PCNs) cannot be issued without a calculation of the tax due. Taxpayers found by HMRC to have a UK domicile will not be able to

appeal this decision pending determination of the tax at stake, so will have to supply details of overseas income and gains.

The taxpayer had applied for a PCN after HMRC issued an information notice requesting details of his overseas income and gains, as he believed that the details were not reasonably required pending determination of his domicile. The PCN would simply refuse his claim to the remittance basis on the grounds that he was UK domiciled, and he could then appeal against it.

HMRC argued that a PCN or closure notice could not be validly issued without quantifying the tax due, for which it needed the details specified in the information notice issued. Domicile could not be entirely separated from the tax calculation. It also contended that a PCN could not be issued without the agreement of HMRC.

The CA found for HMRC, agreeing with the UT in overturning the FTT judgment. It found that a PCN could only be issued for points where a final closure notice could be issued if it was the only point being enquired into. PCNs are subject to the same statutory restrictions as closure notices and must contain a calculation of the tax due. Overall, HMRC did not have the power to issue a PCN without specifying the tax due.

Embiricos v HMRC [2022] EWCA Civ 3

www.bailii.org/ew/cases/EWCA/Civ/2022/3.html

2.4 Former hospital found not to be taxpayer's main residence

The FTT has found that, although the taxpayer claimed to have lived for a year in a large derelict building that he owned, if this had been the case the quality of his occupation was not sufficient to classify it as his main residence. His wife had lived elsewhere, he had not changed his address with any official body, and he had not carried out any renovation work to make the building habitable.

The taxpayer owned a former hospital, for 19 years. On sale he claimed private residence relief for four years of his ownership period, one year of actual residence and three years as the pre-sale period allowed at that time for former main residences. He lived in another property he owned both before and after the claimed year of residence, which remained available to him. No main residence election had been made and for a year the property had been rented out to a school. His wife lived elsewhere and never visited the property.

He argued that he had purchased the property planning to convert it into a large home, and had only ultimately sold it to the local council as he believed that they would otherwise issue a compulsory purchase order, given their keenness to develop the site for residential use. HMRC took the view that the property was purchased as an investment, like other investment properties he owned. Although he had discussed planning permission and talked to developers, which he argued was to create a home, this was consistent with increasing the value of his investment. No renovation work had been done during 19 years of ownership, the property was not suitable for occupation as a home without it, and was in very poor condition, so HMRC believed it was highly unlikely that he had chosen to live there for a year rather than at his other properties. The taxpayer had not changed his address with any bank or other institution, as all post was sent to his workplace, a pharmacy, which was his registered address with HMRC.

The FTT found for HMRC. It held that he had never shown any intention that his claimed occupation would result in the site becoming his long-term residence. No work had been done to renovate the clearly derelict property, and the nature of his claimed occupation was not sufficient to create a claim that it was his main residence. In addition, as his wife had never set foot in the property and was unaware of her husband's plans for it to be the family home, it could not be regarded as her residence, and a married couple can only have one main residence. No findings were therefore necessary on his intentions at the time of purchase, and the CGT assessment and penalties for carelessness were upheld.

Hussain v HMRC [2022] UKFTT 13 (TC)

www.bailii.org/uk/cases/UKFTT/TC/2022/TC08366.html

2.5 Taxpayer wins in business asset disposal relief case

The FTT has found that a partner could claim business asset disposal relief (BADR) on the partnership's sale of an office building, as it was part of the process by which he had disposed of his interest in the business, although the process took 22 years.

In 2017, a partnership in which the taxpayer was a partner sold an office building to his pension scheme. He claimed entrepreneurs' relief, now known as BADR, on the sale, on the grounds that from 1996 he had been reducing his interest in the partnership each year. HMRC contended that the office sale did not meet the requirement of being linked to the disposal as part of the business, as there was no proof of a link. Given that the withdrawal from the partnership took 22 years the sale was not part of the same transaction.

The FTT allowed the taxpayer's appeal, finding that the sale was part and parcel of the wider withdrawal. He had explained the business circumstances that led to extending the withdrawal, but had been trying to dispose of the business throughout, so on the facts of the case BADR was granted.

Thomson v HMRC [2021] UKFTT 453 (TC)

www.bailii.org/uk/cases/UKFTT/TC/2021/TC08337.html

2.6 Taxpayer loses appeal on farming sideways loss relief

The CA has agreed with the UT that an organic farming business was not carried on a commercial basis. The judgment, which overturns an FTT decision, sets out the correct approach to the test for sideways loss relief for farming businesses.

The taxpayer purchased a working farm with surrounding land, but for approximately 17 years did not turn a profit, despite purchases of more land and changes to the way the farm was run. HMRC treated the trade as non-commercial and denied sideways loss relief, on the grounds that there was no reasonable expectation of profit.

The CA agreed with the UT that the correct approach is first to determine what activities were carried on in each year of losses.

If those activities were carried on at the beginning of the year of loss, the test was whether a competent farmer would have then thought that, in those circumstances, a profit would be made but not until after the end of that year.

If so, the test is met and sideways loss relief is available. It is important that the actual activities are considered in this test; general categorisation such as 'organic farming' is not permissible. Under this approach, and based on the expert evidence, there was a reasonable expectation that the business would make a profit long before it actually did. The business was therefore not run on a commercial basis and sideways loss relief was not available.

The CA analysed the UT decision, and the FTT decision, which had been for the taxpayer, in detail, and decided that the FTT had misconstrued the test, by looking at the competence of the individual farmer instead.

Naghshineh v HMRC [2022] EWCA Civ 19

www.bailii.org/ew/cases/EWCA/Civ/2022/19.html

2.7 HC refuses permission to apply for a judicial review on loan charge

A taxpayer to whom the disguised remuneration repayment scheme did not apply has been refused permission to apply for a judicial review. The HC disagreed with his contention that HMRC should not have been able to set the terms of the scheme.

An employee trust made loans to the taxpayer, under a disguised remuneration scheme. The taxpayer signed a settlement agreement with HMRC, repaid the loans to the trust, and the trust settled the tax. He then applied to HMRC for a refund under the disguised remuneration repayment scheme. This scheme can

refund some taxpayers who made voluntary restitution where HMRC did not have the power to recover those amounts.

The taxpayer did not qualify for the scheme as it does not cover loans that had been repaid at the date of the settlement agreement. He sought permission to apply for judicial review on the grounds that this was not the intention of Parliament, and should not be up to HMRC, who had been given power to set the terms of the scheme. Permission was refused, the HC finding that HMRC clearly had the power to place this condition on the scheme, and Parliament had conferred the power on it. His second ground, that the distinction was arbitrary, was also refused

Sibley, R (On the Application Of) v HMRC [2021] EWHC 3195

www.bailii.org/ew/cases/EWHC/Admin/2021/3195.html

3. PAYE and employment

3.1 Taxpayer partially loses appeal on car allowances

The FTT has found that car allowances were earnings, as they were linked to employee grade rather than business use. A part of the allowances can, however, be disregarded, to the extent that the payments were relevant motoring expenditure.

The taxpayer company paid car allowances to employees for some years. It later applied to HMRC to reclaim the class 1 NICs paid on these amounts. HMRC refused on the grounds that the allowance was not tied to mileage, but covered acquisition of the car and all running costs except fuel, so was for purchase of a vehicle rather than use of a vehicle.

The FTT found for HMRC that the car allowance payments were earnings. The amounts were linked to staff grades, rather than aligned to business use, and were not reimbursements for expenses. An amount of the payments was however agreed to be relevant motoring expenditure, so not subject to NICs.

Wilmott Dixon Holdings Limited v HMRC [2022] UKFTT 6 (TC)

www.bailii.org/uk/cases/UKFTT/TC/2022/TC08359.html

3.2 Remuneration trust scheme held to have failed

The FTT has found that payments made by the company to a remuneration trust, which were loaned on to the director, were subject to PAYE.

The taxpayer company made contributions to a remuneration trust, which granted funds to an associated company. The majority of these funds were then lent to the taxpayer company's sole shareholder and director. HMRC raised assessments on the basis that this was a marketed tax avoidance scheme. The company contended that the contributions to the trust were wholly and exclusively for the purposes of its trade, so should be allowed as deductions, and argued that PAYE was not due. The FTT considered the details of the scheme, along with the evidence of witnesses involved in its introduction and relevant case law. Some documents presented by the taxpayer were found to be sham documents so were not allowed to support the case.

The FTT dismissed the taxpayer's appeal. This was a marketed scheme with the purpose of obtaining a tax deduction for the company without creating a tax liability for the director. The loans to the director were a pre-ordained series of steps, inextricably linked to the making of the contributions, to benefit the director's family. It concluded that the contributions were not wholly and exclusively for the purposes of the taxpayers trade and not deductible for CT. The FTT also found that although the amounts lent were not earnings from an employment under general principles, the loan arrangements were employment income subject to PAYE and NICs.

Strategic Branding Ltd v HMRC [2021] UKFTT 474 (TC)

www.bailii.org/uk/cases/UKFTT/TC/2021/TC08348.html

4. Business tax

4.1 Consultation on UK implementation of the global minimum tax rate

The Government is seeking views on the domestic implementation and administration of the OECD Pillar Two model rules, published in December 2021, to ensure large multinational enterprises (MNEs) operating within the UK pay a global minimum 15% tax rate.

The consultation seeks views on how the Pillar Two rules should be implemented into UK legislation. This introduces two charging mechanisms: the Income Inclusion Rule (IIR) and the Undertaxed Profit Rules (UTPR). The UK IIR would apply to MNEs headquartered in the UK with consolidated revenue of more than €750m and imposes a top-up tax on the parent entity where there are overseas subsidiaries located in jurisdictions where the effective tax rate is below 15%. The UK UTPR, which denies deductions or requires an equivalent adjustment, would be limited to UK entities of groups headquartered outside the UK and applies to overseas profits that are not subject to the minimum level of tax.

The consultation seeks views on the common approach, scope, calculation and charging mechanisms of these rules, along with consideration of the transitional aspects, reporting and payments. The Government also set out its proposals for the introduction of a UK domestic minimum tax and the wider reforms to existing UK BEPS measures.

The consultation closes on 4 April 2022. Draft legislation will be published in summer 2022, to take effect from 1 April 2023.

www.gov.uk/government/consultations/oecd-pillar-2-consultation-on-implementation

4.2 Businesses must declare COVID-19 support grants on tax returns

HMRC has issued a reminder for businesses that COVID-19 related supporting grants or payments are taxable and must be declared as income in tax returns when calculating profits.

Taxable COVID-19 related grants include test and trace or self-isolation payments, Coronavirus Statutory Sick Pay Rebate and Coronavirus Business Support Grants. If a company received a Coronavirus Job Retention Scheme grant or an Eat Out to Help Out payment, it should be treated as an income of the company and also be declared in the relevant boxes of the company tax return.

Guidance on which support payments need to be reported to HMRC, and how to report, has been separately published.

www.mynewsdesk.com/uk/hm-revenue-customs-hmrc/pressreleases/hmrc-reminds-businesses-to-declare-covid-19-grants-on-tax-returns-3154337

www.gov.uk/guidance/reporting-coronavirus-covid-19-grants-and-support-payments

5. VAT

5.1 New VAT penalty regime deferred by nine months

The planned reform to the VAT penalty system has been delayed by nine months to allow HMRC to ensure that the IT systems work. It will now come into effect from 1 January 2023.

The planned reform will change the default surcharge to a points-based penalty system. The details have not been changed, but the introduction will now be on 1 January 2023 rather than 1 April 2022. No changes have been announced to the planned introduction of the same penalty rules to IT self-assessment from 2024/25.

https://questions-statements.parliament.uk/written-statements/detail/2022-01-13/hcws537

6. Tax publications and webinars

6.1 Webinars

The following client webinars are coming up soon.

- 9 February: S&W Sessions: VAT/Indirect Tax – new legislation coming into effect in 2022

https://smithandwilliamson.com/en/events/

7. And finally

7.1 Selective tax

January, and the start of a new year, always means something a little different in tax. The Treasury will be delightedly anticipating a big bonanza as the self-assessment payments roll in, though given recent announcements on penalties they may be a little later this year.

Often, those sending off these payments do not cheerfully declare how pleased they are to contribute, but remember all the things they do not wish to fund. They may sympathise with JRR Tolkien, whose 130th birthday falls this month. He once wrote on the cheque by which he paid his income tax *'Not a penny for Concorde'*.

Whilst not at the level of some of his other writings, it certainly conveys the message. Unfortunately, there is no evidence that the Treasury takes the least account of personal opinions written on cheques, but if you really have a pet peeve, why not give it a go and express yourself in style.

https://catholicherald.co.uk/the-catholic-soul-of-middle-earth/

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	RS - Revenue Scotland	SC - Supreme Court	IT - Income Tax	VAT - Value Added Tax
HMT - HM Treasury		UT - Upper Tribunal		

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