Tax update

November 2015

News

HMRC turns the spotlight on contractor loan arrangements

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Responses on penalties

HMRC has published a summary of the responses it received to its consultation document on a new penalties regime. more›

Responses on closure rules

HMRC has also published a summary of the responses it received to its consultation document on its proposals to enable HMRC to close specific issues within a tax enquiry in order to enable that issue to be determined by the Tribunal. more›

Non-dom reforms

The Treasury has commenced a consultation into detailed proposals to amend the tax treatment of individuals who are not domiciled in the UK. The proposals seek to restrict the instances when an individual can claim non-domiciled status and invite views on ways to achieve this. Contributions are to be made by 11 November 2015. more›

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Taxpayer wins residency status appeal

In *Mark Carey v HMRC*, the taxpayer successfully claimed share loss relief. In allowing his appeal, the First-tier Tribunal (FTT) concluded that although he had ceased to be UK resident, he had remained ordinarily resident during part of the relevant year. more›

Tribunal considers what information should be included in a closure notice

In *B & K Lavery Property Trading Partnership v HMRC*, the FTT declined the taxpayer's application to strike out HMRC's case and allowed HMRC's application to amend its statement of case. more›

Tribunal finds HMRC's information notice to be invalid

In *PML Accounting Limited v HMRC*[5], the FTT concluded that a taxpayer information notice was invalid. more›

Any comments or queries?

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News

HMRC turns the spotlight on contractor loan arrangements

HMRC has updated its *Spotlight* publication to comment on contractor loan arrangements which have the effect of reducing taxable income. HMRC states that it is of the view that such arrangements, some of which have been in place and known to it for many years, do not achieve the intended tax saving.

There are a large number of contractors who participated in such arrangements who are currently in dispute with HMRC and this latest *Spotlight* is no doubt intended to pressurise such contractors to accept HMRC's view of the fiscal effect of the arrangements they entered into.

Spotlight 26 can be read here.

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Responses on penalties

HMRC has published a summary of the responses it received to its consultation document on a new penalties regime. HMRC reports that amongst those who responded to the consultation, there was general agreement that there needed to be an effective penalty regime in order to challenge non-compliance, however, many respondents indicated that there ought to be a differentiation between those who generally comply with their obligations but may have slipped up, and those whose non-compliance was persistent. There was general criticism and concern in relation to HMRC's current approach to penalties which many contributors considered to be overly rigid.

HMRC has indicated that it will issue two further consultations relating to reform of the regime applicable to (1) late filing and payment and (2) inaccuracies in returns, in due course.

The *Summary of Responses* can be read here.

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Responses on closure rules

HMRC has also published a summary of the responses it received to its consultation document on its proposals to enable HMRC to close specific issues within a tax enquiry in order to enable that issue to be determined by the Tribunal. There was overwhelming objection to the proposal that only HMRC would be able to make partial closure referrals to the Tribunal. The majority of respondents expressed the view that taxpayers should also be able to make such referrals to the Tribunal. This is the view RPC expressed when submitting its response to the consultation document.

Some respondents also felt that such a power was unnecessary and that proposed safeguards were too weak.

HMRC has said that it will develop alternative models and will consult further. It has indicated that the intention was to include new rules in the Finance Bill 2016, however, it accepted that this may be deferred until 2017.

The *Summary of Responses* can be read here.

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Non-dom reforms

The Treasury has commenced a consultation into detailed proposals to amend the tax treatment of individuals who are not domiciled in the UK. The proposals seek to restrict the instances when an individual can claim non-domiciled status and invite views on ways to achieve this. Contributions are to be made by 11 November 2015.

The Consultation can be read here.

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Cases

Taxpayer wins residency status appeal

In *Mark Carey v HMRC*[1], the taxpayer successfully claimed share loss relief. In allowing his appeal, the First-tier Tribunal (FTT) concluded that although he had ceased to be UK resident, he had remained ordinarily resident during part of the relevant year.

Background

Mark Carey (the Appellant) had been living and working in the UK and was resident and ordinarily resident in the UK for tax purposes. In January 2011, he took a sabbatical from his employment with Sequel Business Solutions Limited (Sequel) to pursue work in Rwanda.

Subsequently, the Appellant exercised share options which he held in relation to Sequel shares on 7 December 2011. He acquired 1,200 ordinary shares. On 9 December 2011, the Appellant's employment with Sequel was terminated and Sequel purchased his shares. All of the negotiations were completed remotely from Rwanda through power of attorney as the Appellant was not in the UK.

In his 2011/12 return, the Appellant included a claim for a capital loss of £145,827 on the sale of his shares to be set-off against the corresponding employment income arising in that year, under sections 131 and 132, Income Tax Act 2007. Sections 131 and 132 provide, so far as relevant, as follows:

"131 Share loss relief
(1) An individual is eligible for relief under this Chapter ("share loss relief") if–
(a) the individual incurs an allowable loss for capital gains tax purposes on the disposal of any shares in any tax year ("the year of the loss"), and
(b) the shares are qualifying shares
[...]

132 Entitlement to claim
(1) An individual who is eligible for share loss relief may make a claim for the loss to be deducted in calculating the individual's net income–
(a) for the year of the loss,
(b) for the previous tax year, or
(c) for both tax years.
[...]"

Under section 16(3), Taxation of Chargeable Gains Act 1992, any capital gains loss accruing to a person is not an allowable loss unless he is resident or ordinarily resident in the UK. The legislation has since changed such that there is no longer a distinction between resident and ordinarily resident, but the principle of residency and allowable loss remains the same. The Appellant could not utilise his claimed loss unless he was able to demonstrate UK residency.

Establishing residency was particularly difficult for the Appellant as he had claimed a split year treatment in his 2010/11 tax return, relying on what was then extra statutory concession A11. HMRC was of the view that this meant the Appellant had ceased to be ordinarily resident in the UK and he could not therefore argue that in the 2011/12 tax year he was ordinarily resident for the purposes of his capital loss claim. HMRC therefore refused his claim and issued an assessment. The Appellant appealed to the FTT.

1. [2015] UKFTT 0466 (TC).

The FTT's decision

The FTT concluded that the Appellant had not ceased to have a voluntary abode in the UK at the time of his departure from the UK. He had agreed with Sequel to take unpaid leave during his sabbatical while he established whether he could make a career in Rwanda. He had retained his shares in Sequel and continued to own a home in the UK.

However, the sale of his shares in Sequel, in December 2011, had the effect of severing the Appellant's ties to the UK and his employer. The proceeds of sale had assisted the Appellant in setting up a new life in Rwanda and although he retained a home in the UK which he rented, there was sufficient evidence that he was no longer settled in the UK, and in the view of the FTT he was not resident in the UK. However, the FTT concluded that as the Appellant had been ordinarily resident in the UK for part of the relevant tax year, his loss was allowable.

Comment

In deciding whether the Appellant was entitled to relief for the capital losses accruing in the year of assessment, the FTT adopted a purposive interpretation of the legislation which allowed relief if a taxpayer was ordinarily resident in the UK during any part of the relevant year of assessment. The FTT said that the Appellant ceased to be UK resident in January 2011, but did not cease to be ordinarily resident in the UK until December 2011.

There is now a statutory non-residence test and the concept of ordinary residence has been abolished which makes the issue of residence and split year treatment clearer for taxpayers. The rules on residence and capital gains tax are nevertheless complicated and cogent factual evidence is likely to be required should residency become an issue with HMRC.

The decision can be read here.

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Tribunal considers what information should be included in a closure notice

In *B & K Lavery Property Trading Partnership v HMRC*[2], the FTT declined the taxpayer's application to strike out HMRC's case and allowed HMRC's application to amend its statement of case.

Background

B & K Lavery Property Trading Partnership (the Appellant) is a partnership of which two brothers are the partners.

The Appellant appealed against a closure notice issued by HMRC on 2 May 2013, following an enquiry into its tax return for 2009/10.

The Appellant's original tax return for 2009/10 showed a loss of £7,224,131. The closure notice amended this to a profit of £672,285. The difference of £7,896,416, was a reflection of the loss of value which had been incurred by the Appellant following the purchase of two properties in September 2007 and July 2008. The Appellant argued that the properties, having been purchased at the height of the property market, subsequently lost value and that their market value as at 5 April 2010 was less than their purchase price. The Appellant's tax return thus included a figure of £7,896,416 for "cost of sales", which the Appellant explained was a "net realisable value adjustment" for the two properties. This was disallowed by HMRC in the closure notice. The relevant words in the closure notice were as follows:

2. [2015] UKFTT 0470 (TC).

"My conclusion

I don't believe the partnership ever commenced trading for reasons already put to your agent and that any expense incurred so far would have to be treated as pre-trading expenditure. I further believe that all income and expenditure contained in the return relates to property investment income. I have therefore amended the return, removing the adjustment for the revaluation of both sites, retained the rental income and allowed the expenditure incurred on a without prejudice basis."

It was common ground that the Appellant's claim for the decline in value of the properties required both of the following two conditions to be met:

- the properties must have been trading stock (as opposed to investment assets) (the Trading Stock Issue)
- the Appellant must have been engaged in a trade in 2009/10, the year in which the loss relief was claimed (the Commencement of Trade Issue).

The Application

The Appellant appealed the closure notice and applied to the FTT to strike out HMRC's case under Rule 8(2)(a) of the Tribunal Procedure (First-tier) Tribunal (Tax Chamber) Rules 2009 (the Rules), on the basis that the conclusion set out in the closure notice was confined to the Commencement of Trade Issue which HMRC had subsequently abandoned and the FTT therefore had no jurisdiction to entertain any argument on the Trading Stock Issue, which was the basis upon which HMRC now sought to argue its case.

The FTT's decision

The FTT considered the leading cases in this area, most notably *Tower M Cashback LLP 1 v HMRC*[3], in which the Supreme Court dismissed the taxpayer's appeal on the closure notice issue. The Supreme Court confirmed in that case that a closure notice completes and states HMRC's conclusions as to the subject matter of its enquiry. The appeal against the conclusions is confined to the subject-matter of the enquiry and of the conclusions, however, the jurisdiction of the FTT is not limited to the issue whether the reason for the conclusions is correct. Accordingly, the FTT may hear any legal argument relevant to the subject matter and any evidence in support of such legal argument, subject to its obligation to ensure a fair hearing.

The FTT also considered the recent decision of the Upper Tribunal (UT) in *Fidex Ltd v HMRC*[4], in which the UT helpfully summarised the applicable principles relating to closure notices and appeals as follows:

- an appeal to the FTT is brought against an amendment of a return which is required to give effect to conclusions stated in a closure notice
- the scope of the appeal is defined by and confined to the subject matter of the enquiry, the conclusions and amendments (if any) set out in the closure notice. An appeal does not permit HMRC to launch a new roving enquiry into a tax return
- it is HMRC's conclusion/amendments in the closure notice which matter, and not the process of reasoning which has led to them
- HMRC does not need to give reasons for its conclusions
- HMRC has a duty to make the closure notice as helpful to the taxpayer as is possible
- the FTT has jurisdiction to entertain legal arguments which have played no part in HMRC's reasoning for the conclusions stated in the closure notice; any element of ambush or unfairness must be avoided by proper case management

3. [2011] UKSC 19.
4. [2014] UKUT 454 (TCC).

- it is a matter for the FTT to identify the subject matter of the enquiry, the conclusions and, therefore, the appeal
- in determining these matters the context is relevant and may include, in addition to the subject matter of the enquiry and the contents of the closure notice, any other relevant correspondence
- in making its determination, the FTT should also balance protection of the taxpayer with the public interest in the collection of the correct amount of tax.

In refusing the Appellant's application and allowing HMRC's cross application to amend its statement of case to reflect its position on the Trading Stock issue, the FTT confirmed that evidence and legal and factual arguments relevant to the correctness of the conclusion stated in a closure notice can be considered by the FTT, even if they played no part in HMRC's reasoning for its stated conclusion. However, the conclusion stated in a closure notice would limit its jurisdiction.

In considering the Appellant's application, the FTT considered that the crux of the issue was whether the Commencement of Trade Issue was the sole conclusion in the closure notice so far as the net realisable value adjustment was concerned, or whether the Commencement of Trade Issue was merely a reason for a broader conclusion that the Appellant was not entitled to make the net realisable value adjustment.

The FTT considered the correspondence relating to the conduct of the enquiry and noted that it was apparent from the outset that the subject-matter of the enquiry was not limited to the Commencement of Trade Issue, or indeed even to the net realisable value adjustment.

The Appellant had argued that HMRC conceded the Trading Stock Issue in correspondence prior to the issue of the closure notice. However, following careful consideration of the correspondence, the FTT concluded that HMRC had not conceded the Trading Stock Issue. The wording used by HMRC in correspondence was not inconsistent with the property being developed as an investment asset rather than as trading stock. Similarly, other correspondence during the enquiry suggested to the FTT that HMRC had declined to confirm that the Commencement of Trade Issue was the only issue to be decided in connection with the net realisable value adjustment and that there might be other issues in an appeal before the FTT. The FTT therefore concluded that the conclusion in the closure notice was that the net realisable value adjustment was disallowed.

Comment

The content of closure notices and the extent to which such content restricts the scope of any subsequent appeal is an important area of the law. This decision provides helpful confirmation of the principles which apply in relation to what information must be included in a closure notice and the scope of the issues to be determined in any subsequent appeal. It is clear from this case that where a taxpayer seeks to limit the issues before the FTT on the basis of the content of the closure notice, careful textual analysis of the enquiry notice itself and all relevant correspondence with HMRC will be required by the FTT in order for it to reach a decision.

The decision can be read here.

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Tribunal finds HMRC's information notice to be invalid

In *PML Accounting Limited v HMRC*[5], the FTT concluded that a taxpayer information notice was invalid.

Background

PML Accounting Limited (PML), provided accounting, tax and corporate services to contractors and consultants. The sole director of PML was Mr Hazell.

On 26 November 2012, HMRC issued a taxpayer information notice to PML, pursuant to paragraph 1, Schedule 36, FA 2008, to "check the company's Chapter 9 ITEPA 2003 position [and...] to give proper consideration to the application of the Managed Service Company Legislation." HMRC suspected that PML was a managed service company (MSC) provider.

After agreeing an extension of time by which to provide the documents requested in the information notice, 16 boxes of documents were sent to HMRC. Following review of the documents, HMRC issued a penalty notice to PML, pursuant to paragraph 39, Schedule 36, FA 2008, for failure to comply, as HMRC was of the view that it had not received all the documents requested in the information notice.

During this period, Mr Hazell became seriously ill and was hospitalised in intensive care for over two weeks. He also lost the use of both of his legs and had to abstain from full-time employment for a period of several months. HMRC wrote to Mr Hazell during that period noting his illness and agreeing to "only" charge daily penalties of £20 per day for failure to comply with the notice. Mr Hazell continued to inform HMRC that he was in no condition to continue to run the company or comply with a document review exercise. His pleas fell on deaf ears and further penalty notices were issued (three in total). The penalties amounted to £4,560 in total.

Following an internal review, which upheld the penalty notices, PML appealed the penalty notices to the FTT.

The FTT's decision

The FTT concluded that the information notice was invalid because PML did not have a present or future tax liability and the appeal was allowed.

The FTT indicated that a third party or "identity unknown" notice under paragraph 2 or 5, Schedule 36, FA 2008, would have been appropriate.

In the view of the FTT, PML's tax liability was contingent on HMRC finding that it was an MSC provider in relation to an MSC, and that the MSC had a liability to account for PAYE that remained unpaid after a specified period, and on that liability being transferred to PML.

At the time the information notice was issued, there was no past or present liability for PML to account for tax, as no notice under Regulation 97C[6] (transfer of debt of MSC) had been issued. Nor could there be deemed to be any future liability for PML to account for tax unless and until:

- it had been determined that PML was an MSC provider in respect to an MSC
- the MSC has a liability to account for PAYE
- that liability had become a relevant PAYE debt by virtue of the service of a Regulation 80 determination (or other specified notice or document) on the MSC

5. [2015] UKFTT 0440 (TC).

- the PAYE debt was unpaid for at least 14 days after service of the determination notice on the MSC
- HMRC was satisfied that the liability of the MSC to account for PAYE was irrecoverable within a reasonable period
- HMRC had issued a direction under Regulation 97C
- a transfer notice in respect of that liability had been served on PML.

All of the above had to be satisfied in order for a liability to exist. Failure to meet all of these conditions meant there was a contingent liability only and this contingent liability did not constitute a "tax position" for the purposes of Schedule 36. Accordingly, the information notice was invalid as it related to the tax position of PML's clients, rather than PML itself.

The FTT also concluded that if it were wrong on the question of validity vis-à-vis the issue of a contingent tax liability, the information notice would also be invalid because it breached PML's clients' rights under Article 8 of the European Convention on Human Rights (right to privacy). PML's clients were unaware of the information notice served on PML and were, therefore, unable to exercise their right to judicial review, resulting in an absence of an effective remedy as required by Article 8.

Comment
This decision is a reminder to recipients of information notices that they need to consider carefully whether the criteria for the issue of a valid information notice are satisfied.

The FTT rejected HMRC's argument that the information notice was issued to PML in order to enable it to obtain information about PML's business which would enable it form a view on its tax position. In the view of the FTT, the possible liability of PML to account for tax under the MSC legislation was "too remote". If HMRC wanted to find out whether PML was a MSC provider in relation to its clients, it could do so by enquiring into the clients' tax positions.

The decision can be read here.

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6. Income Tax (Pay as You Earn) Regulations 2003 (SI 2003/2682).

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