Tax update

July 2015

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Readers will recall that we have commented previously on the decision of the FTT in *Southern Cross Employment Agency Limited v HMRC*[3]. In that case, the FTT allowed the taxpayer's appeal and held that a comprise agreement was binding on HMRC. more›

Any comments or queries?

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About this Update

The Tax update is published on the first Thursday of every month, and is written by members of RPC's Tax Disputes team.

We also publish a general VAT update on the final Thursday of every month, and a weekly blog, RPC Tax Take.

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1. [2015] UKFTT 123 (TC).
2. [2015] UKFTT 135 (TC).
3. [2014] UKFTT 088 (TC).

News

HMRC Spotlight on NICs employment allowance avoidance scheme

On 2 June 2015, HMRC announced that it considers that a scheme that purports to eliminate the user's entire employer NIC liability (via the £2,000 NICs employment allowance) does not work. HMRC has been encouraging scheme users to withdraw from it and to notify HMRC in order to avoid investigation and litigation costs, penalties and interest, on underpaid NICs. HMRC is investigating the use of the scheme and has indicated that it will challenge every case it identifies.

According to HMRC, the scheme involves a payroll company taking on a business's staff and setting up underlying companies, each of which employs small numbers of the staff. The business is invoiced for the services of its now former staff. Each underlying company then claims the full allowance to eliminate the employer NICs liability.

HMRC states that the scheme falls foul of the allowances targeted anti-avoidance rule and as a result, does not work. Further, HMRC's view is that the scheme is notifiable under the DOTAS rules.

You can read more here.

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HMRC publishes revised follower and accelerated payment notices guidance incorporating NICs

On 5 June 2015, HMRC published revised guidance to reflect that, from 12 April 2015, follower and accelerated payment notices apply to NICs.

The changes to the guidance are largely consequential changes, but the following are worth noting:

- The reference in the previous version of the guidance to customer relationship managers having input into the information provided to the senior HMRC panel for follower notices has been deleted.
- The revised guidance confirms that, for APNs, if an arrangement has been used to avoid both tax and NICs, and the DOTAS requirement is met for tax, the DOTAS requirement is treated as met for both tax and NICs even if the NICs element of the arrangement was not disclosable under the NICs disclosure regime.

HMRC also confirms that it will publish separate guidance on the Finance Act 2015 provisions that apply the accelerated payment provisions to group relief.

The guidance can be read here.

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New EU/Swiss transparency agreement

A new agreement has been entered into between the European Union and Switzerland in relation to the automatic exchange of financial account information. The agreement is designed to improve cross-border tax compliance and tackle tax fraud and evasion. It is anticipated that it will come into force in January 2017.

The new measures will lead to the exchange of names, addresses, tax identification numbers and dates of birth of their residents with accounts in Switzerland, on an annual basis, as well as other financial and account balance information.

The EU Commission is concluding similar agreements with Andorra, Liechtenstein, Monaco and San Marino. These are expected to be complete by the end of the year.

The EU Commission's press release can be read here.

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Cases

Tribunal confirms tax relief for expenditure incurred on R&D

In *Pyreos Ltd v HMRC*[4], the taxpayer has successfully appealed HMRC's decision to disallow tax relief for expenditure incurred on research and development (R&D).

Background

Pyreos Ltd (the Appellant) made claims for relief under section 1119, Corporation Tax Act 2009 (CTA), during 2010 and 2012. The claims relied on the Appellant being an autonomous small or medium-sized enterprise (SME), as defined in Commission Recommendation (EC) no 2003/361 (the EC Recommendation).

Under the EC Recommendation, the composition of the shareholdings in the company in question is relevant to determining if such company is an autonomous SME. During the relevant years, Siemens Technology Accelerator GmbH (Siemens) owned between about 49% (in 2010) and 36% (in 2012) of the Appellant's issued share capital. Ordinarily, under the EC Recommendation[5], as Siemens held over 25% of the Appellant's shares, the two companies are considered "Partner Enterprises", and as such the Appellant would not be an autonomous SME entitled to the relief sought. However, the EC Recommendation provides that a company can still qualify as autonomous if the 25% threshold is reached (or exceeded), by investors, including venture capital companies (VCCs).

The material issue for the First-tier Tribunal (FTT) to consider was whether Siemens was a VCC. If it was, HMRC accepted that the Appellant could be considered an autonomous SME and would be entitled to the relief sought.

FTT's decision

The FTT noted that the concept of a VCC was not defined in the EC Recommendation, and it had not been referred to a definition in the present context. As a result, it considered that the phrase was to be construed "in its dictionary sense of a company whose interest is in maximising the financial return on its investments in new businesses and speculative ventures." It noted in this regard that, whilst matters of commercial risk and the date of realisation of potential profits will motivate a VCC, the "day-to-day executive management of the subject concerned in which it invests, would not" and the "nature and pattern of their trading, other than their profitability, would not ordinarily be a matter of concern." Overall, the FTT was of the view that a VCC's interest in such a company was "in the balance sheet value and revenue generation of its investments, and the ability to realise these."

Against that backdrop, the FTT considered that the evidence in the instant case showed that Siemens' objective was "to maximise the financial worth of the Siemens Group's orphan technology." It noted that the relevant IP was not of use within the Siemens Group's own business structure and that so far as the Siemens Group was concerned "its value was so trifling as to be commercially irrelevant." The FTT also noted that, whilst the Appellant did contract with Siemens and/or the wider Siemens Group for certain supplies, such contracting was short-term and conducted at arm's length. In addition, the management of the Appellant was conducted independently of Siemens, and Siemens did not involve itself in matters of the Appellant's routine management.

4. [2015] UKFTT 123 (TC).
5. Article 3, paragraph 2, Annex to the EC Recommendation.

The FTT concluded that Siemens was to be considered a VCC throughout both the relevant years (2010 and 2012) under the EC Recommendation. As a result, the FTT concluded that the Appellant was an autonomous SME and that it was, therefore, entitled to the tax relief sought by virtue of its R&D expenditure. The Appellant's appeal was therefore allowed.

Comment

This was a good result for the taxpayer, particularly considering that the 25% threshold was exceeded by a considerable margin. The decision also provides helpful guidance on the definition of VCCs in the context of section 1119, CTA, and the EC Recommendation. Whilst the FTT considered that ascertaining the meaning of VCCs in this context gave rise to issues of both fact and law, the decision demonstrates the importance of the surrounding factual circumstances and thorough appeal hearing preparation so that the facts relied upon can be established before the FTT.

The decision can be read here.

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Tribunal concludes that HMRC's information request was too vague and ambiguous

There were two matters before the FTT in *Couldwell Concrete Flooring Limited v HMRC*[6]. The first was an application by HMRC to strike out the appeal which Couldwell Concrete Flooring Limited (the Appellant) had made against an information notice issued on 13 January 2014 pursuant to Schedule 36, Finance Act 2008 (FA 2008), on the basis that all of the documents and information required by the information notice formed part of the Appellant's "statutory records", and as such, there was no right of appeal against the information notice[7]. The second matter was an appeal in relation to a further information notice issued by HMRC on 10 March 2014 (the second Notice). In relation to the first matter, the FTT concluded that all of the documents and information requested formed part of the Appellant's statutory records and there was therefore no right of appeal. The Appellant's appeal, in relation to the second Notice, is considered below.

Background

The Appellant's business is laying concrete floors for garages, industrial units and supermarkets. The information notices were issued against the background of an enquiry into possible car benefits and car fuel benefits received by the directors of the Appellant.

The grounds of appeal relied on by the Appellant in relation to the second Notice can be summarised as follows:

- the documents requested were not statutory records
- the information requested was so vague and ambiguous as to be meaningless and impossible to comply with.

FTT's decision

With regard to the first ground, the FTT concluded that the documents requested were statutory records and, as such, there was no right of appeal in relation to that aspect of the second Notice. However, the FTT observed that the terms in which HMRC had identified the documents which were to be supplied were vague. Simply referring to "reimbursements made by individuals" did not identify with "sufficient particularity" which documents were to be

6. [2015] UKFTT 135 (TC).
7. See paragraph 29(2), Schedule 36, FA 2008.

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supplied. The FTT commented "it seems to us that little thought has gone in to the terms of this aspect of the Information Notice". In the view of the FTT, in the event that HMRC imposed a penalty for non-compliance, the vagueness and ambiguity of HMRC's request would become relevant should the Appellant appeal against such a penalty.

With regard to the second ground relied on by the Appellant, the FTT was satisfied that the information requested did not constitute statutory records and, as such, it had jurisdiction, under paragraph 32(3), Schedule 36, FA 2008, to hear the appeal. The FTT agreed with the Appellant that the request relating to the provision of information was vague and ambiguous.

Under paragraph 32(3), the FTT has jurisdiction to confirm, vary or set aside the information notice under appeal, or a requirement contained therein. However, the FTT was of the view that the information request was so vague that it could not reasonably vary it so as to identify the information which would be reasonably required to check the Appellant's tax position. Accordingly, the Appellant's appeal in relation to the information requested was allowed.

Comment

HMRC regularly issues formal information notices during the course of its enquiries and often little thought is given to identifying with sufficient particularity the documents and information requested of the taxpayer. In such instances, where the documents and information requested do not form part of the taxpayer's statutory records, serious consideration should be given to appealing against the information notice. Even in those circumstances where there is no right of appeal against the information notice, it is worth bearing in mind that should an information notice be vague and ambiguous, you may be able to successfully appeal against the imposition of penalties by HMRC for non-compliance.

It is also worth noting that it was accepted by HMRC that when requesting documents, it cannot require those documents to be produced in another format to the one in which they exist.

The decision can be read here.

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Upper Tribunal prevents HMRC from reneging on a settlement agreement – Southern Cross Employment Limited

Readers will recall that we have commented previously on the decision of the FTT in *Southern Cross Employment Agency Limited v HMRC*[8]. In that case, the FTT allowed the taxpayer's appeal and held that a comprise agreement was binding on HMRC. Please click here to read our previous commentary.

HMRC appealed the FTT's decision and the appeal was recently heard by the Upper Tribunal (UT).

Background

In 2009, Southern Cross Employment Agency Limited (Southern Cross) submitted a Fleming claim to recover VAT overpaid in the periods from 1993 to 1997 on supplies of nursing staff. The basis of the claim was that the supplies were exempt from VAT. The claim was initially rejected, however, following correspondence between the parties, in May 2010 an agreement was reached and HMRC repaid Southern Cross 74% of its claim.

8. [2014] UKFTT 088 (TC).

Within three months of the repayment, HMRC changed its position. It wrote to Southern Cross in July 2010 to advise that, following the decision in *Mohair* (FTC/61/2011), it now considered that the supplies were standard rated and not exempt. HMRC issued a recovery assessment to clawback the 74% repayment.

Southern Cross appealed this assessment to the FTT on the basis that the repayment was made pursuant to an enforceable contract in full and final settlement. In allowing the appeal, the FTT considered that:

- the agreement was arrived at following a process of offer, counter-offer and acceptance, and was binding
- the agreement was not ultra vires; HMRC have the power to compromise where the actual tax recoverable has not been quantified
- therefore HMRC had no power to assess and claw back the sums it had paid to Southern Cross.

UT's decision

The UT considered the same three key issues identified by the FTT, although in reverse order.

Did section 80 of VATA 1994 bar HMRC from entering into a binding agreement?

The UT concluded that section 80 did not bar HMRC from entering into a binding agreement to settle a claim. The mechanism provided by section 80 was only intended to prevent taxpayers from seeking to recover overpayments by other remedies, eg common law claims for restitution. It was not Parliament's intention to prevent HMRC from settling claims made under section 80.

The UT commented that parties should not have to resort to litigation to achieve a binding agreement; section 85 makes provision to this effect in the context of an appeal. It therefore concluded that HMRC should be able to, if it so chooses, to dispose of claims under section 80 on a final basis regardless of whether there was a pending appeal.

Was the agreement ultra vires?

In the UT's view, HMRC's decision to enter into the contract was based on good intentions, having regard to relevant considerations at the time. The key question, however, was whether it was fatal to the validity of the agreement that HMRC did not appreciate that Southern Cross's supplies were in fact taxable.

The UT concluded that HMRC could not escape an agreement simply because the supplies had subsequently been shown to be taxable. The fact the supplies have now been found to be standard rated does not mean HMRC misdirected itself in law. At the time the agreement was entered into there was no clarity as to the VAT position and the parties could not have known with certainty the liability of the supplies in question. HMRC could not claim the agreement was invalid as a result of its failure to predict the change in law and in particular the *Mohair* decision.

In the circumstances, and on the evidence before it, the UT found it impossible to determine whether HMRC was conscious that there was doubt over the correct treatment of the supplies. In any event, had HMRC been aware that the supplies might not be exempt, the UT was of the view that that would not constitute an error of law as a state of doubt is different from a mistake.

Was there a binding agreement?
Finally, the UT considered whether a contractual agreement was entered into. They upheld the decision of the FTT and agreed that there was a binding agreement between the parties. Viewed objectively, the pattern of correspondence between the parties, and specific wording used, pointed to a clear process of negotiation and an intention to conclude a contractual agreement.

Comment
This decision is welcome news for taxpayers and provides some certainty for taxpayers who enter into settlements with HMRC. The outcome confirms that HMRC cannot renege on settlements reached with taxpayers in circumstances where the law is clarified after a settlement has been reached.

In this case it was the process, not the outcome, that protected Southern Cross. The compromise agreement reached with HMRC was arrived at following a process of offer, counter-offer and acceptance. Whether a binding agreement exists between a taxpayer and HMRC in other circumstances will very much depend on the facts of each individual case.

In the light of this decision, it is clear that appropriate cogent evidence is crucial. Taxpayers who enter into settlement negotiations or agreements with HMRC are strongly advised to ensure that correspondence and discussions are carefully documented.

The decision can be read here.

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About RPC

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