AAT Tax Update 19 November 2013

In this week's edition of the tax update we look at:

1. Penalty charged even though taxpayer relied on Professional Advice

In **Peter Stratton v Revenue & Customs [2012] UKFTT 578**, the First-tier Tribunal (FTT) has held that a gain made on a disposal of shares was taxable as employment income. The taxpayer, after serving six months as an employee, was awarded some shares. On the sale of the shares, he disclosed the sale as a CGT matter and HMRC contended this was wrong and that the return had been submitted negligently rendering Mr. Stratton liable to a penalty under s95 TMA 1970.

After working for General Healthcare Group for 3 years, Mr. Stratton acquired 250 T shares ("the shares") in GHG in 2001 and paid £6,725 for the shares. On 24 April 2006 GHG was sold to a consortium for approximately £2.2 billion. The consideration was payable in cash and, as regards management's shares of 10%, was paid to management's solicitors, Pinsent Masons, which in turn paid it to members of management.

Pinsent Masons produced a briefing paper which advised:
"T Shares only: These shares are taxed under the conditional share regime. The full amount of the gain will be subject to income tax at the shareholders marginal rate, which will be paid under the PAYE system, and national insurance contributions. The amount of PAYE and employees national insurance contributions will be deducted from the consideration to be received by such Shareholders and paid over to HMRC by GHG."

On 10 May 2006 the Appellant surrendered the 250 T shares to GHG and received a payment of £382,748. GHG deducted income tax and NIC from the sum of £382,748 under the PAYE Regulations.

On 20 November 2007 the Appellant filed his self-assessment income tax return for the year ended 5 April 2007 declaring the income of £382,748 but claiming a deduction of the same amount, thereby reducing the PAYE chargeable income to nil and resulting in a refund claim in respect of the £153,099.24 of income tax deducted by GHG. Instead, the Appellant declared a capital gain of £95,894.25 (after taper relief) in respect of his disposal of the shares in his return.

Mr. Stratton was advised in relation to his tax by a firm called Daniels Travers. They advised him that the disposal was one which would be subject to capital Gains tax and not income tax. HMRC opened an enquiry and asked to see any advice received as well as all the documents relating to the purchase and sale of the shares. When these were not provided HMRC threatened to use its access powers to obtain the information.

HMRC asked the advising firm of Daniels Travers to explain the reasoning behind the Appellant's contention that the sale of the shares was not subject to income tax and why the "conditional shares" legislation (section 427 ITEPA 2003) did not apply.

The advising firm seems to have relied on legislation which did not apply to the shares acquired by Mr Stratton but Mr Stratton had sought advice and he argued he was not negligent if that advice was wrong.

The penalty is subject to HMRC's powers of mitigation, pursuant to which the penalty of £23,650 was set at 20% of the extra tax due.

In the view of the FTT, the return was negligently made by Mr Stratton. Daniels Travers seemed either reluctant or unable to engage with HMRC in correspondence in relation to the relevant ITEPA 2003 provisions. Indeed, insofar as Daniels Travers explained the rationale behind the position taken by the Appellant in his tax return, it seemed to ignore the relevant provisions of ITEPA 2003 altogether. Moreover, when Daniels Travers did eventually consider the relevant provisions it appears that they were working from a version of the legislation which did not apply to the Appellant's disposal of his GHG shares. Indeed, in reviewing the correspondence between HMRC and Daniels Travers, it is hard to avoid the conclusion that the applicable ITEPA provisions had not been considered by the Appellant's advisers when the return was submitted. The failure to consider the application of the "conditional share" provisions of ITEPA 2003 was negligent.

The FTT concluded that there was no reasonable basis for the view taken by Mr. Stratton in his tax return. It was plain which provisions HMRC considered to be applicable and no sensible argument was put forward in correspondence by the Appellant or his advisers as to why ss422-427 ITEPA 2003 did not apply.

Where, on advice, a taxpayer has an arguable case that the tax claimed by HMRC is not due; reliance by the taxpayer on that advice will not normally be regarded as negligent for the purposes of penalty proceedings even if it turns out that the advice was incorrect. However, it cannot be correct that in cases where there is no reasonable basis for the advice or the advice was based on a simple failure to consider the relevant statutory provisions, reliance on such defective advice can constitute a reasonable excuse for the purposes of section 118 (2) TMA 1970. Otherwise, a mistake of law or ignorance of the law could constitute a reasonable excuse – a consequence which Parliament cannot possibly have intended.

This decision is a must read for every practitioner. The UK tax regime is complex and voluminous yet ignorance of a provision and reliance on incorrect advice from a professional adviser is not a reasonable excuse so the tax and penalties were collectable and Mr. Stratton will have paid a heavy price for his mistaken claim(s).

Commentary: A reasonable excuse is normally an unexpected or unusual event that is either unforeseeable or beyond the taxpayer's control, and which prevents the taxpayer from complying with their obligations. A combination of unexpected and foreseeable events may, when viewed together, be a reasonable excuse.

It is necessary to consider the actions of the taxpayer from the perspective of a prudent taxpayer, exercising reasonable foresight and due diligence, having proper regard for their responsibilities under the tax acts.

In Rowland V HMRC [2006] STC (SCD) 536, a persuasive authority only, the Special Commissioners decided that a taxpayer who had relied on the incorrect advice of their agent had a reasonable excuse. Mistakes in complex tax legislation should not be penalised but in Mr Stratton's case the evidence showed that he had been advised that the receipt should be recognised as employment income. He even declared the receipt in his return as employment income and then claimed a matching deduction before disclosing that he believed he had made a capital gain on the disposal. Put bluntly, no prudent person would have behaved in such a way unless they had some strong arguments which supported their treatment and contradicted the advice which had been received.

Find out more about 'reasonable excuse' on the HMRC website.

2. National Insurance Bill Research paper published

At 24 pages in length, **this research paper 13/60** explains how the new employer's allowance of up to £2,000 will work when it is introduced from April 2014. Employers are liable to pay secondary Class 1 National Insurance contributions (NICs) at 13.8% on all employee earnings above the secondary threshold, set at £148 a week. This employers' allowance is estimated to cost the exchequer £1.26 billion in 2014/15, rising to £1.73 billion by 2017/18.

The **National Insurance Contributions Bill 2013-14** was published on 14 October. It was scheduled to have its Second Reading on 4 November 2013.

NIC is the UK's second biggest tax after income tax, in terms of the amounts of money it raises for the Exchequer. In 2012/13 NICs raised £102 billion, which compares with receipts of £152 billion for income tax, £101 billion for VAT and £41 billion for corporation tax.1 It is projected that in 2013/14, NICs will raise just over £106.5 billion, of which £85.8 billion will go into the NI Fund and £20.8 billion will go to the NHS.

In addition to explaining the employers' allowance in simple terms, the briefing paper also explains how the bill will extend the GAAR introduced into Finance Act 2013 to NIC. There are measures to tackle avoidance which used LLPs to disguise employment status and also offshore intermediaries.

3. HMRC publish a new 'spotlight' advising that a share avoidance scheme does not work

HMRC has won another case in the tribunals involving an attempt to avoid tax and National Insurance contributions on employee bonuses. In **LM Ferro Ltd v HMRC** a bonus was paid in the form of an award of shares. The decision confirmed HMRC's view that these types of devices to avoid tax simply do not work - if you pay what is really a bonus, tax and NICs are due no matter how it is dressed it up.

The scheme in LM Ferro was marketed by Powrie Appleby but similar avoidance schemes were marketed by other promoters. HMRC considers cash received by beneficiaries of awards in those schemes is also chargeable to Income Tax and NICS.

HMRC expects those who used these schemes to make full payment of the tax and NICs due, plus interest. Those companies and employees affected should contact HMRC to settle their liabilities and prevent additional interest accruing. You can contact HMRC on Telephone 03000 532624.

Penalties may be charged if you failed to take reasonable care when making returns to HMRC. Tribunal decisions do not establish legal precedent but they might be persuasive to other tribunals and Courts.

You can read more about the HMRC announcement on the HMRC website.

4. Withdrawal of VAT concession for RFSC and partial exemption

The **partial exemption concession on Road Fuel Scale Charges** (RFSCs) will be withdrawn with effect from 1 January 2014. Taxpayers who currently use the concession need to take action if they are to continue to achieve a fair result following withdrawal.

RFSCs are an optional way of calculating VAT on deemed supplies created when taxpayers allow business road fuel to be used for private journeys. They avoid the need to keep detailed mileage records to accurately calculate private usage.

Where taxpayers are partly exempt and VAT on road fuel is treated as residual declaring RFSCs can lead to unfair results. This is because output tax will be declared on the full value of private use fuel whereas input tax will only be claimable in part on that fuel according to the taxpayer's partial exemption recovery rate.

The concession corrects this unfairness by allowing the RFSCs to be reduced by applying the partial exemption recovery rate to them. This means that the output tax declared on private use fuel is consistent with the actual input tax deduction on that fuel. However HMRC needs to either withdraw concessions or bring them into law and this concession cannot be legislated.

HMRC's brief suggests the use of a 'fuel sector' in the partial exemption method and a formula that, according to HMRC, produces broadly the same overall outcome as the old, concessionary, restriction on output VAT. There are other options to produce a fair result including keeping detailed mileage records and the brief points out that businesses can agree alternative methods.

5. PGA subscriptions are not allowable for tax purposes

HMRC specifically accept that a professional membership fee or an annual subscription may be deducted if the subscription meets the conditions of ITEPA 2003, s. 343 or s. 344.

For relief to be due, two general conditions need to be met:
(1) the duties of the employment must involve the practice of the profession to which the fee relates
(2) the registration, certification, licensing or other matter in respect of which the fee is payable must be a condition (or one of alternative conditions) that have to be met if that profession is to be practised in the performance of those duties.

HMRC have the power to add other types of fee and the bodies that have been approved by the Board are listed in a publication **('List 3') available on the HMRC website**

In **The Professional Golfers Association (PGA) Ltd v The Commissioners for Revenue & Customs [2013] UKFTT 605**, the PGA were appealing HMRC's decision to refuse approval for the association.

The PGA, based at the Belfry, has approximately 7,500 members. About 6,000 of them are based in the UK and Ireland, and about half of these perform a fairly traditional "Pro" role at a golf club or driving range. The remainder have a wide range of activities related to golf, from specialist golf retailing to course design, managing entire golf resorts or individual coaching. PGA members generally make their living from the business of golf, not from playing it competitively.

The PGA's predecessor association was given a cup by one Samuel Ryder in 1927, to be competed for on a biennial basis by teams of professional golfers from the USA and Great Britain. The biennial Ryder Cup was effectively moribund (it was won by the USA on 17 of the 19 competitions following the Second World War) until it was decided in 1979 to extend it into a USA versus Europe competition and the European team finally won the cup at the Belfry in 1985. Since then, the Ryder Cup has become a very successful international sporting event. The PGA is entitled to a 20% share of the profits from the Ryder cup and this gives it an income of about £1.6million annually. There is no prohibition on the distribution of assets by way of dividend or otherwise prior to a winding up.

There are extensive powers in the Regulations to discipline members, including the power to fine, suspend or expel them.

The PGA employs approximately 125 people and its accounts for the year ended 31 December 2010 showed total turnover (for the company alone) of £11,874,403 and a total cost of sales of £11,599,832. In addition, it had some investment activities which generated further profits of £155,000. It also showed a profit share from an associated undertaking (Ryder Cup Europe LLP) of £275,000 for the year. In its consolidated profit and loss account, the turnover and cost of sales figures were both approximately £170,000 more (reflecting the consolidation of a small subsidiary company PGA Golf Management Limited) but the "share of results of associates" was shown in the much greater sum of £1,668,000, all of which was attributable to the Ryder Cup (made up of £1,393,000 of "operating profit" and £275,000 of "distributions").

The current subscriptions are of the order of £375 per year. One of the basic entry requirements for PGA membership is to play with a handicap of no more than 4 (or 6 for ladies). The PGA organises regular tournaments for PGA Pros – either "Pro-only" tournaments (for PGA members only) or "Pro-am" tournaments (where a PGA member plays with three amateur players in a team, against other similar teams). It organises between 500 and 600 such tournaments per year, of which about 80% are "Pro-am". All these tournaments have entry fees and pay prize money (some provided by the Appellant and some by sponsors). In a "Pro-only" tournament, PGA professionals compete only amongst themselves. In a "Pro-am" tournament, they compete for a team prize with their three amateur team members but also separately for an individual professional prize. Whilst the prize money might form a useful supplement to a player's earnings, it would not really be possible to make a living by playing tournaments. Some of these tournaments (usually Pro-am ones) find it possible to attract a sponsor to assist with the costs and/or prize money (often some local business).

Section 344(2) sets out the list of what might be called “permitted objects”:

“(2) The objects are:
(a) the advancement or dissemination of knowledge (whether generally or among persons belonging to the same or similar professions or occupying the same or similar positions)
(b) the maintenance or improvement of standards of conduct and competence among the members of a profession,
(c) the provision of indemnity or protection to members of a profession against claims in respect of liabilities incurred by them in the exercise of their profession.”

The statutory condition requires the Appellant’s activities to be “wholly or mainly directed” to these objects.

56% of the Appellant’s expenditure is, according to its own analysis, directed to its “tournaments” activity. This means that it fails the wholly or mainly test and as a result cannot be given the approved status necessary for employees to obtain a tax deduction.

So it is bad news for golf pros but good news is there for AAT members because AAT is on list three and subscriptions to working AAT members are deductible for tax purposes.

Derek Allen
19 November 2013