AAT Tax Update 30 September 2014

In this edition of the tax update which is now on a monthly basis we look at:

1 Company cars advisory fuel rate reduced for diesel from 1 September 2014
2 Taxpayer has right to appeal an HMRC assessment in avoidance dispute
3 HMRC publish two more toolkits to help taxpayers get it right
4 HMRC systems incorrectly issues some penalty warning letters to employers
5 Financial Reporting Council publish three XBRL taxonomies on 15 September

1. Company cars' advisory fuel rate reduced for diesel from 1 September

Paying expenses at rates which can be covered by a dispensation can save significant administration costs for employers and employees. HMRC have published new advisory fuel rates from 1 September 2014. The rates for petrol cars have not changed.

For one month from the date of change, employers may use either the previous or new current rates, as they choose. Employers may therefore make or require supplementary payments if they so wish, but are under no obligation to do either. Rates for diesel cars with engines of 2,000cc or less have been reduced by 1p. Larger diesels over 2,000cc remain unchanged at 17p a business mile.

http://www.hmrc.gov.uk/cars/advisory_fuel_current.htm

2. Taxpayer has right to appeal an HMRC assessment in avoidance dispute

I have to declare a conflict of interest before I summarise this case because I believe that tax avoidance is legal but that some artificial avoidance schemes fail what I call the "smell test" and deserve to be struck down.

In Neil Pattullo v Revenue & Customs [2014] UKFTT 841, there were three issues:
(1) the validity of a *discovery* assessment issued in January 2010, relating to the Appellant's Self Assessment Tax Return for the year 2003/04, charging tax of £835,400.60 in respect of a claim to set off against capital gains, a capital loss created by entering into various tax planning arrangements,
(2) whether the issue of validity has already been determined by the Court (*res judicata*), and (3) whether the grounds of appeal may be expanded at this late stage to challenge the underlying soundness of the assessment (and possibly its quantification), if valid; that is, to contend that the tax avoidance scheme actually worked.

The avoidance scheme used was the second hand insurance policy scheme (SHIPS) similar to that struck down by the Court of Appeal in 2009 in the Drummond case. Mr Patullo argues firstly that there was no *discovery* at all within the meaning of s29(1)(a), (b) or (c), and secondly, that by the date of closure of the statutory enquiry window, HMRC could have been reasonably expected on the basis of information then available and contained in the Appellant's return or reasonably to be inferred therefrom, to be aware of the insufficiency of tax assessed in the Appellant's return.

Not only does the avoidance scheme fail my 'smell test' but the disclosure was in my view short of what is required to enable an officer to understand how the loss arose. Mr Patullo disclosed at Box 8.22, under the heading *Additional Information*, the following is set out:-

> *1 On 24 February 2004 I settled an interest in possession trust with £6,000.*
> *2 The trust is called "The Pattullo 2004 Life Interest Settlement".*
> *3 I Borrowed on commercial terms a sum of £2,665,000 from Investec Bank UK Ltd and settled this amount into the trust.*
> *4 The Trustees "Nexus Trustee Company Limited" used the funds to acquire a number of Capital Redemption Contracts on 1 March 2004 for £2,665,000 from Rockville International Corp.*
> *5 The trustees appointed the Capital Redemption Contracts to me on 4 March 2004.*
> *6 I surrendered the Capital Redemption contracts on 8 March 2004 and received redemption*

proceeds of £2,600,000.
7 This has given rise to a capital loss as a consequence of s37(1) TCGA 1992 amounting to £2,665,000.

The deployment of Capital Redemption Contracts (CRCs) appears to have been the tax avoidance industry's reaction to that anti-avoidance legislation although CRCs were used for tax avoidance purposes in the 1930s and again in the late 1990s. Capital redemption business carried on by insurance companies consists of effecting (on the basis of actuarial calculations) contracts, which, in return for one or more fixed payments, a sum or a series of sums of a specified amount becomes payable on a specified date or over a period. The nature of the insurance business must not be life insurance. UK insurance companies do not carry on capital redemption business. This is because of the various complexities of regulatory issues relating to insurance law in the United Kingdom. All CRCs involved in tax avoidance schemes were issued by non-UK resident companies.

The law was changed with effect from 10 February 2005 by virtue of the Finance (No 2) Act 2005 Schedule 7 paragraph 14 when changes were made to corporation tax. Changes to the treatment of CRCs for capital gains tax purposes applied with effect from 5 December 2005. This, as we have noted, prevents the effective operation of the CRC Mk II scheme by clarifying that CRCs are not chargeable assets for capital gains tax purposes.

Mr Patullo did not mention in his tax return that he was using a scheme so it would have been difficult for an average officer to have appreciated or understood the complex technicalities. This meant that the protection available to taxpayers who make a full disclosure was not available to Mr Patullo.

On 28 October 2006, Mr Patullo was informed that his affairs were under investigation and HMRC asked for additional information which Mr Patullo declined to provide. With the Drummond decision in 2009, HMRC concluded that there was an insufficiency in Mr Patullo's return and raised a discovery assessment.

The tribunal ruled that:

"In our view, a reasonable reading of the Appellant's return would not make a hypothetical officer aware that there was an insufficiency of tax. He could not reasonably have become aware of an insufficiency. The information was incomplete as several boxes were blank. The white space gave minimal details. CRCs and their use as part of tax avoidance arrangements would not be generally known to a hypothetical officer at the relevant date. It took several years and three rounds of appeals to determine the proper scope of s37 of the 1992 Act. As at 31 January 2006, *Drummond* would at best have been at an embryonic stage. We doubt whether a hypothetical officer would have been aware of it at that time" (paragraph 77)

HMRC's argument that Mr Patullo was trying to abuse the process was rejected with: "While it may be said that the Appellant, through his tax advisers, has acted aggressively, we do not consider that he has acted improperly or in a manner which a court would or even might characterise as unacceptable. He was entitled to raise judicial review proceedings. Substantial arguments were advanced on his behalf. Although he lost, his case was not hopeless or unstateable"...

But Mr Patullo's counter argument that he wished to challenge the Drummond decision on some as yet unspecified ground but extending his original appeal reasons was similarly rejected.

This is an interesting but complex appeal and those interested in the technicalities of discovery, the taxpayers rights of appeal and the interaction with judicial review should read http://www.bailii.org/uk/cases/UKFTT/TC/2014/TC03958.html

2(b). No right of appeal on HMRC exercising its discretion

In a totally unrelated case, Tindale v Revenue & Customs [2014] UKUT 324, the Upper tribunal had to decide whether it had jurisdiction to hear an appeal against a discretionary decision made by HMRC in relation to Error or Mistake relief.

Mr Tindale was claiming a repayment of the PAYE which had been deducted by his customers who treated him as an employee when he was self employed. Although the tax and NIC had not been quantified, all accepted in principle that Mr. Tindale would receive a windfall as the tax and NIC paid as an employee would be considerably more than he was due to pay as a self employed individual.

Mr. Tindale was claiming relief under Section 33 Taxes Management Act 1970 ("TMA") in respect of the years 1997-98 to 2001-02 inclusive. This is a discretion given to HMRC to give such relief as is just and reasonable and it is well established that the only right a taxpayer has if he disagrees is judicial review. But Mr. Tindale was bringing a new argument that on a point of law about the measure of the profits he had a right of appeal under s33(4A) TMA 1970.

HMRC investigated Mr Tindale's employment status in 2003 after he had completed returns as a self employed sales person and concluded that Mr Tindale had an employment contract with a Danish company - Dynaudio (although the conclusion was that he was employed by Dynaudio Limited). HMRC also concluded that "Dynaudio Limited" had no UK base. HMRC's decision referred to the fact that where a foreign employer with no UK base had engaged an employee on an employed basis income tax and national insurance would be collected from the employee (paragraphs 25 to 26 of the Decision).

The basis of the claim for relief was that Dynaudio did have a taxable presence in the UK; was bound to operate PAYE and therefore Mr Tindale was entitled to repayment of the whole of the tax paid by him in respect of the income he had returned as self-employed income in the relevant years. Factually, Dynaudio had not operated PAYE claiming it was not resident in the UK and without a tax presence. In essence, what Mr. Tindale wanted was a repayment from HMRC of the tax which Dynaudio ought to have deducted if he was an employee but which would need to be funded by the general body of taxpayers and which would exceed his liability for tax if Mr. Tindale had been self employed (which HMRC had ruled he was not self employed).

The Upper tribunal ruled that it had no jurisdiction to hear the appeal but it did advise that Mr Tindale could pursue other rights, for example Judicial review. I hope that he does not pursue this further because at this stage the prospect of success looks like zero. He made a mistake and 17 years later he is still arguing. Status disputes are notorious for the length of time they take to settle and this case illustrates how important it is to get things right from the outset.

http://www.bailii.org/uk/cases/UKUT/TCC/2014/324.html

3. **HMRC publish two more toolkits to help taxpayers get it right**

Toolkits to help minimise common errors - update
HMRC has updated and published the Small Profits Rate and Marginal Relief Toolkit. Nineteen out of twenty toolkits have now been refreshed and include the new checklist functionality to add notes, save and print client information.

4. HMRC systems incorrectly issues penalty warning letter to employers

PAYE for employers: P11D(b) interim penalty warning letter

Benefits in kind are reported on form P11D. A very small number of employers have incorrectly been sent an interim penalty warning letter when they have, in fact, submitted their P11D(b) for 2013/14. Having identified the mistake, HMRC are sorting the problem. All of the records impacted by this issue of incorrect penalty notices will be updated and a penalty will not be charged so an employer receiving an incorrect notice need take no action.

5. Financial Reporting Council (FRC) publish three XBRL taxonomies on 15 September

Taxonomies or tagging conventions enable accounts to be filed electronically, and also allow users of information in corporate reports such as HMRC and Companies House to extract the data they want and analyse it more effectively. The taxonomies will support XBRL reporting under the new UK GAAP standards, FRS 101, FRS 102 and EU-adopted IFRS.

https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2014/September/FRC-publishes-conventions-for-electronic-tagging-o.aspx

Derek Allen
30 September 2014
Set your diaries for the next edition of the general tax update which will be published around 31 October 2014