AAT tax update 31 July 2015

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

1. employee travel expense avoidance scheme
2. Finance Bill 2015
3. CGT rules must be claimed exactly for EIS relief
4. consultation on Deeds of Variation
5. announcement of review of IR35 legislation
6. announcement of reform of replacement furnishings allowance

1. Employee travel expense avoidance scheme confirmed as failed

With £158 million at stake, I can understand why Reed Employment pursued its appeal against the Upper tribunal decision that a scheme which it had arranged to reduce tax and NIC on employee expenses and subsistence did not work. The decision on **Reed Employment Plc & Ors v Revenue and Customs [2015] EWCA Civ 805** was published on 28 July 2015.

The case concerns a travel and subsistence scheme operated by Reed, where they claimed they operated a salary sacrifice scheme for employed temporary staff. The scheme was trying to take advantage of the tax relief which is available to an employee whose travel expenses and subsistence when visiting a temporary workplace is paid by the employer. The obvious stumbling block was that agency staff take up short term appointments but they are employed at the site at which they work; they are not visiting their short term work place. Reed's appeals were dismissed by the Upper Tribunal which saw no reason to interfere with the judgement of the First Tier Tribunal, and their application for judicial review refused.

Reed had obtained PAYE dispensations to cover the allowances concerned. This was a mistake made by the then Inland Revenue which changed its mind in 2004 and sought to recover the tax and NIC from Reed which the Revenue thought had been underpaid. However, Reed Employment took the view that they had implemented a salary sacrifice scheme which, coupled with the dispensations, meant that the allowances did not come within PAYE, and were also exempt from NICs. HMRC did not agree but please note that some 11 years have passed before this dispute has arrived at a Court of Appeal decision.

When the employed temps were receiving the expense allowance arrangement after accepting a salary sacrifice, it did not matter what they called it. In reality, the payments being received by the temporary workers were just additional salary. These payments might have been described as an expense allowance but the tribunal had found as a fact that the payments were additional salary. The temporary workers were engaged under a series of job-by-job contracts, and not under a continuing overarching employment contract. Thus the 'salary sacrifice' arrangement was ineffective, and PAYE and NICs were due on travel and subsistence payments made under the scheme.

2. Summer reading - Finance Bill 2015

What summer I ask? The month of July has been cold, wet and windy, but if you need some summer reading, the summer **Finance Bill 2015** and **explanatory notes** have been published.

At 212 pages, containing 50 clauses and eight schedules, accompanied by 132 pages of notes, this is heavy reading especially when combined with all the consultation documents which have been issued.

3. CGT rules (very unfair decision) must be claimed exactly for EIS relief

In tax there is no room for equity or fairness. HMRC must apply the law strictly but there are many examples which illustrate that the strict application of the law can produce a very unfair and unjust result. HMRC care and management provisions are supposed to reduce situations which are clearly unfair and unintended but if HMRC decide not to exercise its discretion then there is really no effective right of appeal.

In Ames v Revenue & Customs (INCOME TAX/CORPORATION TAX: Exemptions and reliefs) [2015] UKFTT 337 (TC), Mr Robert Ames invested £50,000 in shares which HMRC accepted were eligible for Enterprise Investment Scheme (EIS) income tax relief. However, Mr Ames did not claim that relief because he had no taxable income in the relevant year.

On 17 June 2011 Mr Ames sold the shares for £333,200. He did not include the gain of £272,540 in his self-assessment calculation because he understood that there was no CGT on disposal. That was true for all the other investors who had claimed income tax relief. However HMRC contended that the CGT exemption was only available if EIS income tax relief had been claimed. His liability was recalculated to include tax of £72,811.20.

Now if I pause here, HMRC have argued for many years that avoidance schemes which rely on technicalities but do not respect the spirit of the law are abusive and unacceptable. Yet here we have HMRC arguing for a technicality which clearly does not respect the spirit of the law and if the HMRC argument succeeds will disadvantage one taxpayer for not claiming a relief to which he was entitled. The stink in this case gets worse because Mr Ames tried to make a late claim for income tax relief which HMRC has the discretion to allow, but HMRC refused to allow the claim because in HMRC's view Mr Ames had no reasonable excuse for not making the claim in good time. The key issue for determination was whether the gain on Mr Ames' shares was exempt from CGT, or whether it was taxable because Mr Ames had not claimed EIS income tax relief.

The CGT exemption in dispute is set out at TCGA s 150A. At the time Mr Ames disposed of his shares, the first two subsections of that provision read:

> "(1) For the purpose of determining the gain or loss on any disposal of shares by an individual where–
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> a. an amount of EIS relief is attributable to the shares, and
>
> b. apart from this subsection there would be a loss, the consideration given by him for the shares shall be treated as reduced by the amount of the EIS relief.
>
> (2) Subject to subsection (3) below, if on any disposal of shares by an individual after the end of the period referred to in section 312(1A)(a) of the Taxes Act or section 159(2) of ITA 2007 where an amount of EIS relief is attributable to the shares, there would (apart from this subsection) be a gain, the gain shall not be a chargeable gain."

The decision of Anne Redston makes an interesting read because it discusses statutory interpretation and the possibility of a reverse Ramsay type argument. However what is clear is that Parliament does not appear to have considered the possibility that a person would invest out of capital, as Mr Ames did by selling his marital home, in a year when his income was negligible. Ms Redston also considered whether the Human Rights Act might help Mr Ames and she gives a **detailed discussion** which concludes that the HRA cannot help him.

I feel sorry for Robert Ames. He has to pay the tax assessed. The result is unfair but it illustrates that the CGT exemption associated with EIS shares requires a claim for income tax relief. All tax advisers would note this and make sure that a claim for at least £1 of income tax relief is made when a client invests in EIS shares.

4. Consultation on Deeds of Variation (DoV)

On 15 July HMRC announced a **consultation and review** of DoV's. The aim of the review is to:

- explore the circumstances in which DoV are used for tax purposes
- develop an understanding as to the frequency with which DoV are used for tax purposes

- examine how the current tax provisions around DoV are operating
- establish what changes, if any, should be made to the current tax rules

The deadline for responses is 7 October 2015. I think, and this is a personal view, that IHT is a very unfair tax and is in need of reform. A deed of variation can allow some effective tax planning after the death by amending the will and the provision is a valuable safeguard which I hope is retained.

5. Review of IR35 legislation announced

I am biased and I think that the enactment and subsequent retention of the IR35 legislation is a disgrace. It is bad legislation which does not work and it should have been repealed.

Legislation was introduced in 2000 to tackle the avoidance of employment taxes by those who work through intermediaries, primarily their own company, often known as a Personal Service Company (PSC).

The government believes this is not working as effectively as it should be and non-compliance with the legislation is widespread. I cannot argue with this point because the defects in the IR35 legislation were apparent right from the start and it should never have been enacted. IR35 is unfair as two people doing the same job, in the same way, can end up paying very different levels of tax depending on how they are engaged, and this costs the Exchequer a significant amount each year. This cost will increase as the number of people working through PSCs continues to grow.

At the Budget the government announced that HMRC would start a dialogue with business on how to improve the effectiveness of the existing intermediaries' legislation, commonly known as IR35. HMRC will engage with stakeholders over the next few months to explore options to make the legislation more effective in protecting the Exchequer and levelling the playing field between direct employees and those who work in a similar manner to direct employees but through their own limited companies. This **document** sets out a framework for those discussions and covers:

- the rationale for change
- options to improve the effectiveness of the rules; and
- next steps.

6. Reform of replacement furnishings allowance announced

The Government has issued a consultation on replacing the furnished lettings wear and tear allowance (10% of rent receipts) with a relief based on costs actually incurred on replacement of furnishings for all residential landlords. Responses are requested by 9 October 2015. With the substantial increase in the number of buy to let properties this issue will be important to many clients. The proposed changes are likely to become effective from April 2016 onwards.

The new replacement furniture relief will only apply to the replacement of furnishings. The initial cost of furnishing a property would not be included. The new proposals would not affect Furnished Holiday Letting (FHL).

Under the new replacement furniture relief landlords of all non-FHL residential dwelling houses will be able to claim a deduction for the capital cost of replacing furniture, furnishings, appliances and kitchenware provided for the tenant's use in the dwelling house, such as:

- movable furniture or furnishings, such as beds or suites
- televisions
- fridges and freezers
- carpets and floor-coverings
- curtains
- linen
- crockery or cutlery
- beds and other furniture

Fixtures integral to the building that are not normally removed by the owner if the property was sold would not be included because the replacement cost of these would, as now, be a deductible expense as a repair to the property itself. Fixtures include items such as:

- baths
- washbasins
- toilets
- boilers
- fitted kitchen units

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The views expressed in these podcasts are Derek Allen's personal views and do not necessarily represent AAT policy or strategy.

There will be another general tax podcast updating AAT members on recent developments and decisions available on the website on 31 August 2015. For those interested in VAT, there should be an update available on 14 August 2015