Tax update – 29 February 2016

In this month's tax update we look at:

1. tax avoidance: HMRC and public hardening attitude
2. mistakes punished by HMRC seeking inappropriate penalties
3. employers action to reduce the administration relating to reimbursed expenses
4. payment to avoid bankruptcy not allowable as an expense of lawyer's profession
5. HMRC plans for change by 2020

1. Tax Avoidance: HMRC's and public's hardening attitudes

I watched a recent Dispatches programme which informed me that there are currently 22,298 pages of tax legislation. In my view, with a self-assessment regime, having 22,298 pages of complex legislation is so inappropriate that our legislators should hang their heads in shame. It really is a disgrace.

With such complexity, it is hardly surprising that the UK tax regime is viewed as unfair and that inequalities abound. Sensible tax planning to achieve a sensible commercial outcome which takes advantage of tax reliefs and incentives in the way that was intended should not be criticized. Conversely, there are schemes which are blatantly artificial and fail what I call "the smell test". In other words, such schemes stink.

The problem for the average taxpayer may be that they do not understand the tax law and they are reluctant to pay more tax then they need to pay. Good advisers give good advice and can help their clients claim the incentives and reliefs to which they are entitled. Good advisers can also help their clients appreciate the wider picture and help them to consider other aspects like their commercial reputation and the public reaction if somehow confidential information about their tax affairs should leak into the public domain.

The Dispatches programme appeared to suggest that paying tax was a voluntary choice and that it was possible to eliminate any UK income tax bill. My initial reaction on watching the programme was one of disappointment that the coverage was so superficial.

Tax avoidance has become an emotive and unclear term. It may be legal but no one is clear about where the watershed lies between acceptable avoidance and unacceptable or egregious schemes. But this coming March we have been warned to expect a Finance Bill that has draft clauses designed to tackle avoidance and punish those thought guilty of abusing the tax legislation.

We can expect:

- a new criminal offence for tax evasion which will remove the need to prove intent for the most serious cases of failing to declare offshore income and gains;
- new tax geared civil penalties for offshore tax evaders and those who help them. Naming and shaming evaders and their enablers is on the cards;
- a new criminal offence for corporates failing to prevent tax evasion or facilitating tax evasion;
- new measures for serial avoiders (i.e. those who persistently enter into tax avoidance schemes that are defeated by HMRC). Including restrictions on accessing certain tax reliefs;
- and a new penalty (of 60%) for cases successfully tackled by the General Anti-Abuse Rule (GAAR) which will be amended so that it targets abusive avoidance better.

Salary sacrifice arrangements are under scrutiny and I anticipate legislation coming soon to challenge this practice if tax avoidance is thought to be the motive.

The above list is not exhaustive but it illustrates that those who plan for tax will need to understand where the watershed lies between acceptable tax planning and egregious avoidance.

HMRC have given some guidance and commentary on tax avoidance schemes stating:

1. **Most schemes don't work**
2. **It could cost you more than you bargained for**
3. **You may have significant legal fees to pay**
4. **You could face criminal conviction**
5. **You could face publicity as a tax avoider**
6. **Your scheme is never HMRC approved**
7. **You could be marked out as a high-risk taxpayer**
8. **HMRC is likely to beat your scheme in court**
9. **The risk is normally all your own**
10. **You'll have to pay the tax up front anyway**

Read more about misleading claims made by tax avoidance scheme promoters in **Spotlight 29.**

HMRC has also published **new statistics** which reveal that they have collected over £2bn of tax which is being disputed but which HMRC believe is related to an avoidance scheme which does not work. How the tax world has changed because 30 years ago, HMRC could not take debt recovery action until the assessment had been settled, usually by agreement but sometimes by the judicial appeal process. Now if HMRC thinks it is due the new Accelerated Payments notices mean that users of tax avoidance schemes pay disputed tax up-front while their tax-affairs are investigated, instead of waiting until they are concluded. Given HMRC wins 80% of cases that go to court, this eliminates the financial advantage that tax avoiders previously enjoyed.

In practice, pursuing an appeal can often take over 10 years to get to tribunal. Even if you win the appeal and recover the money, the taxpayer may face adverse publicity and commercial damage from having pursued an appeal. My concern is that the pendulum has swung the other way too far. It is now going to cost money to have an appeal heard and the tribunal decisions provide many examples that HMRC make many mistakes and are often guilty of maladministration. Now, more than ever, it is important that taxpayers get it right because getting it wrong can be expensive, time consuming and stressful.

2. Mistakes punished by HMRC seeking inappropriate penalties

We used to be able to trust HMRC to act in a reasonable manner and to exercise sound judgement. Considerable evidence now exists that HMRC are ignoring the reassurances provided at the time of consultation on the penalty regime that mistakes would not be penalized.

In **Usher & Anor v Revenue and Customs (VAT - APPEALS : Extension of time) (Rev 1) [2016] UKFTT 50**, the executors of an estate of approximately £1.5 million had filed the deceased income tax return for the year up to date of death (2012/2013). They omitted certain investment income causing income tax of £14,458 to be underpaid but they had correctly disclosed the asset position for the IHT return.

On 26 September 2013, an executor had written to the Revenue sending a cheque for £15,332.92, which was then the outstanding tax due, and saying:

> I will have to presume this is in full and final settlement, as I am now proceeding to finalise and distribute the estate.

The executors proceeded to do that, but they failed to publish notice in the London Gazette of their intention and giving a deadline for any further claims. However, exactly a year later on 26 September 2014 the Revenue wrote raising queries on the accuracy of the return which had been filed for 2012/13. The penalty of £5060.18 was assessed by HMRC on the basis that the executors' conduct had been "deliberate but not concealed".

Now pause for a minute. This has all the hallmarks of a guddle leading to a mistake. The executors had disclosed the correct position in the IHT return which enabled HMRC to identify that the income had been under assessed. The HMRC reasoning in regard to the penalty of £5060.18 was that since the inheritance tax return in January 2013 contained the correct figures of the deceased's investment income, the executors "must have known" in August 2013 when they filed the income tax return that the figures in the two returns did not match. The executors had known what they were doing and therefore their action was deliberate.

35% of the estate went to charity. For the executors, Mr Usher submitted that the Revenue's delay of one year in responding to his letter of 26 September 2013 was unacceptable and was the proximate cause of the predicament in which the executors now found themselves – having distributed all the estate and having no legal right of reimbursement against the beneficiaries.

The executors could have had no possible reason to try and evade the comparatively small amount of tax at issue. The error made in the 2012/13 return had been genuine and unintentional, and the correct tax could easily have been paid had the Revenue asked for it in good time. As laymen, the executors did not know, and could not be expected to have known, that an advertisement in the London Gazette of their intention to distribute the estate would have safeguarded their position.

The factors which influenced the tribunal are:

(i) that executors have told us that they are far from sure that they will find the beneficiaries, particularly the charities, willing to reimburse them the tax at issue and which they must still pay, and

(ii) that the Revenue have admitted that their own delay in dealing with the case was blameworthy – which we add, had it not occurred, might well have spared Messrs Usher and Perkins the difficulty they are in now.

On balance, the tribunal thought it right therefore to reduce the penalty in this case to nil. The assessment to tax however must stand good, and with it the interest due. This seems to me a just result. However, I think that HMRC deserve criticism for seeking a penalty when it was clear that the executors had made a mistake.

3. Employers action to reduce the administration relating to reimbursed expenses

The P11D dispensation is due to end on 5 April 2016, so employers need to apply to HMRC before then for a new Approval Notice to pay reimbursed to employees expenses and allowances to their employees without needing to operate PAYE/NIC. This change to administration will apply to all allowances other than a handful of new statutory rates agreed for subsistence, overseas subsistence rates, advisory fuel rates and working rules agreements.

Failure to obtain an Approval Notice by 6 April 2016 for all other allowances may mean tax and NIC liabilities are incurred until one is agreed. If the employer has not obtained Approval Notices, the employer will have to operate PAYE tax and NIC on making payment to the employee. In order to obtain appropriate Approval Notices, employers must have installed processes to check employee claims for payment against the expenditure they incur, including sampling. The withdrawal of dispensations previously available under s65 ITEPA 2003 will cause a lot of employer's administrative difficulty. For example, if the employee travels using an oyster card or uses contactless or cash for small items, how is the employer to check that the expense has actually been incurred?

Don't delay and good luck in negotiating sensible procedures and rates.

4. Payment to avoid bankruptcy not allowed as an expense of lawyer's profession

The Upper tribunal has overturned the decision of the First tier tribunal (FTT) in **R&C v Peter Vaines [2016] UKUT 0002**. The FTT had allowed the lawyer's claim to be able to deduct a payment of €300,000 to Bayerische Landesbank on the basis that the payment was incurred wholly and exclusively for the purposes of the profession or trade that the Respondent (Mr Vaines) was carrying on and that the payment was revenue and not capital expenditure. The FTT found, as a matter of fact, that Mr Vaines purpose for making that payment was to preserve and protect his professional career.

Nevertheless, the trade that he was carrying on and in respect of which the profits had to be computed for the purposes of the charge to income tax was SS&D's trade as carried on in common by all the members and not by Mr Vaines alone. As such, his payment of €300,000 fell to be deducted, if at all, in the context of SS&D's trade as so carried on and not as the First-tier Tribunal supposed by reference to his circumstances alone.

I am not surprised that the UT overturned the FTT decision. There had to be an element of duality of purpose relating to such a payment and with the reasoning that the payment related to Mr Vaines' circumstances it was inevitable that the deduction should be denied. The First-tier Tribunal's conclusion that, as a matter of fact, his purpose in making the payment was "to preserve and protect his professional career or trade" is of no assistance to Mr Vaines. It indicates that this was a personal expense, directed at resolving Mr Vaines' situation, and not one that was related to the professional activities of SS&D that he was carrying on in common with the other members of the firm.

If the banks had been ultimately successful he could have lost his position as a partner in the London firm. The FTT concluded that Mr Vaines carries on a profession as an individual although collectively in partnership with others so his profits are taxed on him individually. It had held the payment was incurred wholly and exclusively for the purposes of that profession.

The Upper Tribunal disagreed and their decision is a precedent. The deduction had to be justified in the context of the partnership trade (SS&D) of the law firm conducted collectively. The payment was not wholly and exclusively incurred for the purposes of Mr Vaines' profession but discharged a personal liability. It had been incurred in relation to the previous partnership of which he was a member but it could not be said to satisfy the test of being wholly and exclusively for the purposes of his current partnership.

This means that Mr Vaines has paid €300,000 (£215,455) to release him from all claims to the Bank and yet he will be unable to claim a deduction for tax purposes. That is the law but it is unjust.

5. HMRC plans for change by 2020

I read and cringed to read the spin which HMRC now produces but which in my view indicates that the integrity which I expect to see from HMRC is lacking. In my view, based on my own limited experience, HMRC service delivery is absolutely dreadful. Despite this, HMRC claim to be a doing a great job, in **gathering tax and increasing tax yield.**

It is laudable to have aspirations and I would support HMRC in its efforts to improve. What I wish is that HMRC would concentrate in doing simple things to improve compliance like answering the phone in a reasonable time and responding to letters within a reasonable time. HMRC promises good things for the future including:

- transforming HMRC approach to compliance, using HMRC's 'promote, prevent, respond' strategy to tackle non-compliance – HMRC's aim is to:
    - promote compliance by designing it into systems and processes
    - prevent non-compliance at or near the time of filing
    - respond to non-compliance through well designed delivery

Derek Allen
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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 a general tax podcast updating AAT members on recent developments and decisions, including the budget, available on the website on 31 March 2016.