Tax update 31 March 2016

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1. Termination Payments: whether damages for injury to feelings was exempt

I felt really sorry for Mr Moorthy when I read the decision of the Upper Tribunal (UT).

In **Moorthy v Revenue & Customs [2010] UKUT 13**, Mr Moorthy had settled a dispute with his previous employer on the basis of a compromise agreement and a payment of £200,000. In addition he had received statutory redundancy of £10,640 which was accepted by all as being within the exemption of £30,000.

Mr Moorthy had declared that he had received the termination payment less £34,000 tax deducted at source but then claimed in his tax return that the whole payment was exempt within s406 ITEPA 2003. Mr Moorthy was seeking a repayment of the £34,000 tax deducted at source. Not surprisingly, HMRC opened an enquiry and in the ensuing discussion and negotiation they offered to settle on the basis that Mr Moorthy could have the full £30,000 exemption, as well as a concession of a further £30,000 conditional on Mr Moorthy accepting that the balance of £140,000 was taxable.

Hindsight is a wonderful thing and I anticipate that Mr Moorthy wishes he had accepted the HMRC settlement offer. But he did not and appealed to the FTT which found that Mr Moorthy had received a termination payment of £200,000 against which he had a balance of £19,360 exemption remaining, and the remainder was taxable. Mr Moorthy appealed to the UT trying to introduce new arguments.

It is an interesting decision of the UT because they have reviewed Employment tribunal decisions and considered carefully whether a payment for injury to feelings fell with s406 ITEPA as a payment for injury or disability. After careful analysis they concluded that injury to feelings was not an injury and so the payment was taxable.

The UT also considered whether the offer made to settle by HMRC should be available to him. Was he entitled to a legitimate expectation that his position should not be worsened by taking an appeal to tribunal? Clearly Mr Moorthy felt that the concession which HMRC had offered him should be available to reduce his tax bill. However, the tribunal concluded that it had no jurisdiction to rule on the exercise of HMRC's discretionary powers. HMRC's offer was conditional on Mr Moorthy accepting the settlement and when Mr Moorthy did not accept the concessionary offer it was withdrawn.

I feel sorry for Mr Moorthy because his appeal was doomed to failure from the outset.

2. Losses available to carry forward even though return submitted late

I hesitate to mention that for many years I was a member of the HMRC powers consultative Committee. I was proud of the work which we did. We tried to give HMRC the powers that they needed and the penalty sanctions to deter taxpayers from noncompliance while ensuring that mistakes would not be penalised.

Anecdotal evidence suggests to me that HMRC is abusing the penalty regime, seeking to impose penalties when taxpayers make mistakes. Like the loss making share trader case which I summarized last month in which HMRC tried to impose a penalty (disgraceful mismanagement on the part of HMRC) **Bloomsbury Verlag GmbH v Revenue & Customs (INCOME TAX/CORPORATION TAX:**

Assessment/self-assessment) [2015] UKFTT 660 illustrates maladministration by HMRC when it sought a penalty of 20% and attempted to deny a company any relief for the initial losses it had incurred when it became resident in the UK and liable to our taxes.

HMRC denied relief for trading losses incurred in earlier periods on the grounds that the earlier periods were out of time and tax for 2005 is charged by way of a discovery assessment made on 14 September 2012 in the amount of £146,546.70. The tax for 2007 arises from a closure notice and Revenue amendment of the same date in the amount of £66,073.50.

The Company was a German incorporated wholly owned subsidiary of Bloomsbury Publishing Plc (Plc). Plc acquired the Company on 14 March 2003 and it became UK resident by virtue of its being centrally managed and controlled in the UK thereafter. It remained UK resident at least until its sale by Plc to a German subsidiary of the Bonnier media group on 28 March 2012.

The Company did not immediately appreciate that a particular consequence of the management arrangements that were adopted from 14 March 2003 meant that it had come within the charge to corporation tax as a UK tax resident company. It was only on 31 March 2010 that Deloitte LLP wrote on behalf of the Company to HMRC to inform HMRC that, following a review, Deloitte had concluded that the Company had become UK resident on 14 March 2003. This notification took the form of an 'Error or Mistake Claim' under paragraph 51 of Schedule 18 to the Finance Act 1998 (hereafter "Schedule 18") in respect of the Company's accounting period ended 31 December 2006. HMRC agreed, following a review, that the Company was tax resident from 14 March 2003. Deloitte disclosed:

> Our work to date has identified that [the Company] incurred combined Schedule D Case I trading losses and non-trading loan relationship deficits in its accounting periods ended 31 December 2003, 2004, 2006 and 2009 of £1.36m, £1.48m, £0.14m and £0.76m respectively, while it made taxable profits in its accounting periods ended 31 December 2005, 2007 and 2008 of £0.4m, £0.3m and £0.1m respectively.

Relief for a trading loss being carried forward is given by section 393 ICTA which provides (so far as relevant):

> "(1) Where in any accounting period a company carrying on a trade incurs a loss in the trade, the loss **shall be set off** for the purposes of corporation tax against any trading income from the trade in succeeding accounting periods; and (so long as the company continues to carry on the trade) its trading income from the trade in any succeeding accounting period **shall then be treated as reduced by the amount of the loss**, or by such of that amount as cannot, under this subsection or on a claim (if made) under section 393A(1) be relieved against the income or profits of an earlier accounting period.
>
> (7) The amount of a loss incurred in a trade in an accounting period shall be computed for the purposes of this section in the same way as trading income from the trade in that period would have been computed.
>
> (10) In this section references to a company carrying on a trade refer to the company carrying it on so as to be within the charge to corporation tax in respect of it."

I have highlighted the relevant words to show that relief for a trading loss being carried forward is mandatory and does not require a claim. This is an interesting but lengthy decision but paragraph 137 concludes in favour of the company:

> ".As.regards the 2005 period, the 2004 losses can be set off as indicated in (2) above. We also think that there is nothing to prevent the 2003 losses being set off in 2005 given that relief under section 393 is allowed as part of the computation of trading profits for the year and there is no longer any requirement to claim the losses or to have them determined in an earlier

year. The fact that they relate to a year in which HMRC did not require the Company to submit a company tax return does not appear to prevent it establishing the existence of the losses and their availability for set off in self-assessing its profits in a later year, and we so decide.

(4) As regards the 2007 period the same principles will apply as in 2005"

The tax and penalties sought for both periods are reduced to zero. From an administrative perspective, this is a significant persuasive decision about time limits and claims to relieve a trading loss carried forward. The outcome seems just. But what about the arguments promoted by HMRC? Denying relief for trading losses actually incurred would not have been within the spirit of the law but reading the arguments I can appreciate that it was a complex area. In my view, as soon as you have a taxpayer making a claim that was reasonable, even if that claim is incorrect, it should be clear that a penalty cannot be charged and yet here we have evidence that HMRC are abusing the penalty regime and seeking penalties when it was incorrect to so do. HMRC should improve its internal review process and it should respect the principles of fairness and the spirit of the law.

3. Entrepreneur's CGT relief denied on a timing technicality

HMRC are required to enforce the strict letter of the law but they do have a degree of discretion to allow concessions which are reasonable and just. HMRC used to exercise that care and management discretion in a reasonable way but these days the evidence is considerable that HMRC pursue a policy of strict interpretation and enforcement even when the result seems unjust and outside the spirit of the law.

An example of denying an individual a relief to which he would otherwise have been entitled is **J K Moore v Revenue and Customs UKFTT (2016) 0115.**

The disputed issue was Mr Moore's shares in Alpha, a business distributing electronic components. He was one of the founding shareholders and directors. Prior to 2009, he held 3000 of the 10000 issued £1 shares, held the office of Sales and Marketing Director and was employed under a contract of employment.

On 29 January 2009, one of the Alpha directors instructed solicitors to draft the necessary contractual documentation for settlement to terminate Mr Moore's employment based on terms agreed through the mediation/negotiation process conducted by Mr Mehta. These terms were set out in an unsigned and undated document supplied by Mehta & Co to the solicitors under cover of an email dated 17 February 2009.

In summary, the terms were agreed such that Alpha would purchase 2700 of the Appellant's 3000 shares; the remaining 300 shares would be converted to non-voting shares and clearance would be sought from the respondent that Alpha's acquisition of the shares would be treated as a capital transaction (Company purchase of own shares).

On 29 May, Mr Moore signed a Compromise Agreement for the termination of his employment and the Agreement for Purchase of Own Shares. All Companies House papers concerning the Appellant's resignation as a director were also signed on that day. However, such documents state the effective date of his resignation as a director was 28 February 2009. The timing was crucial. By his self-assessment tax return to 5 April 2010 Mr Moore declared the share sale for capital gains tax purposes claiming Entrepreneurs' Relief pursuant to section 169M Taxation of Chargeable Gains Act 1992 ("TCGA").

HMRC denied the claim arguing that Mr Moore was not entitled to claim Entrepreneurs' Relief amounting to £37,384 because the statutory conditions set out in section 169I(6)(b) TCGA had not been met. Specifically, he was not, throughout the period of one year ending with the disposal of his shareholding, either an officer or employee of Alpha.

Before the Tribunal it was contended that the disposal of the shares giving rise to the capital gain was in fact "some time in February 2009" when negotiations were complete between the parties. This follows from section 28 TCGA 1992, which provides that the date of disposal is the date of the contract for sale. It was contended that the completion of the negotiations resulted in a binding contract for sale in February 2009.

HMRC argued that if there was an oral agreement it must have been conditional on the Respondents' clearance for the company's purchase of its own shares and upon confirmation of additional funding for the purchase of the shares. In other words, HMRC was responsible for the delay in the condition being satisfied and on that technicality the shares were sold three months after the employment had ceased.

There is no dispute between the parties that save for the condition in Section 169I(6)(b) all the conditions for a material disposal which would benefit from Entrepreneur's relief are otherwise met. Section 169I(6)(b) however provides that "throughout the period of 1 year ending with the date of disposal …. the individual is an officer or employee of the company. Remember that this company was set up in 1995 and Mr Moore has been a director for 14 years. The spirit of the law would suggest Mr Moore is clearly entitled to retirement relief and this persuasive decision of the FTT is a warning to all tax advisers of just how important it might be to ensure that the timing is examined and structured carefully.

There was only one matter in dispute and that matter is one of mixed fact and law: was there an unconditional contract for disposal 5 of the shares by 28 February 2009? The tribunal ruled that Mr Moore ceased to be a director and employee of the company on 28 February but the disposal was delayed until 29 May because the company needed to pass a resolution and lacked the funds to make the purchase.

Mr Moore contended that the disposal occurred on 28 February, the date when agreement was reached on the exit package. Approval for the purchase of shares and further financing for the company was not made, however, until 29 May 2009. It was held that the disposal happened on 29 May 2009 when Mr Moore was no longer an office holder or employee and therefore he was not due any entrepreneurs' relief on the disposal of his shares. This is undoubtedly the right decision based on the correct interpretation of the law. It illustrates the principle that it isn't what you do but the way that you do it which matters in tax. Had Mr Moore been well advised and continued as a director until the shares were sold, he would have got the relief. I feel quite sorry for him that he did not receive good advice and as a result paid a lot more in tax.

4. HMRC publish new advisory fuel rates for company cars.

Advisory fuel rates in pence per mile that can be used by employee company car drivers changed from 1 March 2016, with small changes (a reduction) to some of the rates, following the recent fall of pump prices.

These rates apply from 1 March 2016. You can use the previous rates for up to 1 month from the date the new rates apply.

Engine size	Petrol - amount per mile	LPG - amount per mile
1400cc or less	10 pence	7 pence
1401cc to 2000cc	12 pence	8 pence
Over 2000cc	19 pence	13 pence

Engine size	Diesel - amount per mile
1600cc or less	8 pence
1601cc to 2000cc	10 pence
Over 2000cc	11 pence

Hybrid cars are treated as either petrol or diesel cars for this purpose.

5. **Tax relief for approved Professional bodies**

The good news is that subscriptions by accountants to AAT are approved and deductible for tax. **Read more here.**

6. **Budget 2016**

I listened to the Chancellor's speech on 16 March, his fourth 'budget' in twelve months. What a disgrace! A competent fiscal policy should not require such frequent change and in a self-assessment regime surely someone can see that the sheer volume and complexity of the UK tax law is verging on the absurd. No one reads it, few understand it and as several of the cases summarised above show it is too complex for HMRC to manage properly.

If the Chancellor can talk for over an hour and yet fail to mention significant changes he is introducing, this five minute podcast cannot do justice to the detail. A few highlights include:

Pensions

This chancellor should be ashamed of the way he tinkers with and threatens the scheme for pensions. Any pension savings regime needs to be stable and certain. A prudent person needs to be confident that a decision to set aside money for the future will remain a sensible decision when the future arrives. Reducing the lifetime allowance to £1million already means that there is inadequate incentive for a high earner to save using a conventional pension scheme. Unless annuity rates improve dramatically, a pension fund capped at £1 million will not provide the income and security for a middle income earner.

The Chancellor unveiled a new Lifetime ISA, which is intended to allow adults aged under 40 the opportunity to save up to £4,000 a year towards buying their first home (up to a limit of £450,000) or to save towards their retirement, and which the Government will top up by 25%. This is saving funded from tax paid income.

Capital Gains Tax

CGT rates will also be cut, with the headline rate falling from 28% to 20% and the basic rate from 18% to 10% with effect from 6 April 2016. There are a lot of changes to Entrepreneur's relief.

Other highlights include:

- Corporation tax to reach 17% from April 2020
- Stamp duty on commercial property reduced for lower bands
- Income tax personal allowance rising to £11,500 from April 2017
- Class 2 NICs for the self-employed abolished from 2018
- ISA allowance to rise to £20,000
- New sugar levy on soft drinks from 2018
- NIC on termination payments from 2018

Full details can be read here.

Derek Allen
31 March 2016

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 available on the website on 30 April 2016.