

PRACTICE UPDATE

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1. Property businesses - repairs

Distinguishing between repairs expenditure and capital costs is often difficult. The distinction can become even more difficult in the case of an old, dilapidated building.

Where there's a Will(s)...

In *Christopher Wills v Revenue & Customs* [2010] UKFTT 174 (TC), the taxpayer appealed when HMRC disallowed a claim for £43,665 in respect of repairs to an outbuilding attached to a rental property. The total cost of the work was £106,707, with the balance being treated as capital expenditure. The outbuilding was a listed building, which had become extremely run down and was in a dangerous state of disrepair. Because the building was listed, there was no option other than to undertake a substantial repair scheme. Prior to the repair work, the outbuilding was used for storage, as a games room and additional living space, and for a few years sometimes as a garage. The claim for repair costs was based on an agreed split between repairs and renewals for VAT purposes.

HMRC argued that the repair work was part of a wider capital scheme to convert the outbuilding into additional living space, and that all the expense should be treated as capital expenditure. However, having examined the architect's plans and report, the tribunal found that the disputed work undertaken was one of essential repair.

The taxpayer's appeal was therefore allowed.

PIM2020

Interestingly, the tribunal found that their decision was 'supported' by HMRC's property income manual at PIM2020, which features relatively extensive guidance on the deductibility of repairs from property income. With regard to work done on an old property, the guidance states: 'A repair or replacement of a part of a building using modern materials may give an apparent element of improvement because of the greater durability, superior qualities and so forth of the new material. But the cost normally remains revenue expenditure where any improvement arises only because the taxpayer uses new materials that are broadly equivalent to the old materials.'

Having said that, the guidance goes on to warn: 'Where a significant improvement arises from the change of materials, the whole of the cost is capital expenditure.' This includes items such as redecoration after the main work has been done. However, HMRC accepts that replacing part of the 'entirety' with the nearest modern equivalent is allowable as a repair for tax purposes as a 'like for like' replacement.

Finally, although HMRC guidance does not carry the force of law, the reference to PIM2020 in the *Christopher Wills* case suggests that reading PIM2020 and the case itself may be helpful in practice, in addition to reviewing established case law

such as *Conn v Robins Bros Ltd* [1966] 43 TC 266, *Lurcott v Wakely & Others* [1911] AER 41 and *William P Lawrie v CIR* [1952] 34 TC 20, all of which are mentioned in PIM2020.

2. Gift Aid problems

The reduction in personal allowances for those with income exceeding £100,000 was introduced from 6 April 2010 for 2010-11 and later years. The effect of legislation introduced in Finance Act 2009 is that personal allowances above that level are tapered away, and at current levels are reduced to nil if adjusted net income exceeds £112,950, with an effective tax rate of 60% for income within the lower and upper income bands.

Tax planning in this area therefore revolves around ensuring that adjusted net income remains outside the reduction thresholds. 'Adjusted net income' is defined (in ITA 2007, s 58) in terms which allow relief for pension contributions, and for gift aid contributions carried back. The facility to carry back gift aid contributions (by election under ITA 2007, s 426) is a potentially useful form of tax planning because it involves a degree of hindsight.

Not so fast...

However, care is needed if such planning is to succeed. The gift aid legislation requires that an election to carry back a qualifying donation must be made on or before the date on which a tax return is delivered for the previous tax year (i.e. the tax year for which relief is to be given), and not later than the normal self-assessment filing date for that previous tax year.

In *John Cameron v CRC* [2010] UKFTT 104 (TC) TC00415, Mr Cameron was a farmer who realised a substantial sum on selling a large part of his farming assets in 2005/06. He wished to use part of the sum to establish charitable trusts to enable young people to see the World. His advisers told him that a donation to charity in 2006/07 could be carried back to the 2005/06 under gift aid. Mr Cameron's

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2005/06 tax return had been submitted to HMRC in August 2006. The charitable trust was created in November 2006, and Mr Cameron donated £936,000 to the trustees in that month.

When was return 'delivered'?

Mr Cameron's advisers submitted an amended 2005/06 tax return on 29 January 2007, claiming gift aid by election against his income and gains of 2005/06. HMRC enquired into the return and refused the claim, contending that the claim could only be made in the original return. Mr Cameron's appeal was broadly on the basis that his 2005/06 return was 'delivered' when it was amended, and therefore the carry back election was made when the return was delivered, and was therefore on time.

Unfortunately, the tribunal held that a natural and literal reading of the relevant legislation meant that the time limit for the gift aid carry back claim was by reference to the date when the original return was delivered to HMRC. The taxpayer's appeal was dismissed, although the tribunal Judge added: "I would like to have held in Mr Cameron's favour but on the words of the statute, I am unable to do so."

In a nutshell

Interestingly, the tribunal Judge summed up HMRC's position (and the shortcomings of the legislation) in this way: "...in effect [HMRC] said: "if only Mr Cameron had not been so prompt and diligent in submitting his return, if only he had waited until 29 January 2007 before submitting his complete return, then all would have been well and he would have got his relief, but as it was his prompt compliance was his undoing.""

In effect, the taxpayer was penalised for being efficient. The moral in this case seems to be that if a gift aid carry back claim is in prospect, it would be prudent to delay filing the earlier years' return until just before the normal filing date, if possible.

3. Disappearing ESCs

Extra Statutory Concessions (ESCs) have been with us for decades, but are now slowly disappearing. This follows the House of Lords' decision in *R v HM Commissioners of Inland Revenue ex p Wilkinson* [2006] STC 270, which raised issues about the validity of ESCs and the extent of HMRC's discretion to make and apply them under its care and management (now 'collection and management') powers in TMA 1970, s 1(1).

The *Wilkinson* case resulted in HMRC reviewing all ESCs. Consequently, some ESCs have become law, whilst others have simply continued. However, a number have been withdrawn completely. It is clearly important to be aware in particular about those ESCs which have been withdrawn.

Going..going...

HMRC issued the Technical Note 'Withdrawal of extra statutory concessions' on 9 December 2009 (see <http://www.hmrc.gov.uk/pbr2009/withdrawal-extra-stat-con-5325.pdf>). The document provided details of 9 ESCs to be withdrawn, which in HMRC's view appear to be obsolete. HMRC stated: 'Where an ESC has to be withdrawn, HMRC recognise that taxpayers may have to make adjustments, and will generally offer an appropriate period of notice before the concessionary treatment formally comes to an end.'

Subsequently, on 2 June 2010, HMRC announced (in Revenue & Customs Brief 24/10) the withdrawal of a further ESC of greater importance. ESC B46 ('Automatic penalties for late company and employer's and contractors' end of year returns') will be withdrawn on 31 March 2011. ESC B46 provides that HMRC will not charge a penalty for corporation tax or employer and Construction Industry Scheme end of year returns received on or before the last business day within 7 days following the statutory filing date. This concession was helpful, particularly for larger businesses.

HMRC commented in its Brief 24/10 that the move towards statutory online filing of tax returns means that ESC B46 has become 'redundant' as the possible causes of late filing it was intended to address (e.g. postal delays) can no longer arise. Businesses affected by the withdrawal of the concession will need to argue that there was a reasonable excuse for late filing, and possibly appeal against late filing penalties before the Tribunal.

The future of ESC C16?

Another popular and commonly used concession is ESC C16 ('Dissolution of companies under sections 652 and 652A Companies Act 1985: Distributions to shareholders'). This concession broadly allows distributions in the course of dissolving and striking off a company to be treated as capital (as opposed to income) receipts in the hands of the shareholders, if certain conditions are satisfied. The concession is intended to save the costs of a formal winding up of the company.

HMRC has considered the introduction of legislation so that ESC C16 is replaced but effectively becomes law. However, certain issues and concerns have been raised. In particular:

- In HMRC's view, it would require lengthy and complex legislation to formally implement ESC C16;
- HMRC also considers that ESC C16 is used for tax avoidance purposes. The legislation would therefore need to be drafted to prevent abuse.

On the first of HMRC's concerns, it is surely not beyond the draftsman's capabilities to legislate for ESC C16 in relatively straightforward terms. After all, the Tax Law Rewrite Project has resulted in a whole raft of simpler (albeit considerably longer) legislation.

With regard to the second bullet point above, HMRC has provided no evidence that ESC C16 is being abused, which suggests that the abuse is more perceived than real. In any event, the answer to the

problem would surely be to make the legislation subject to a statutory clearance procedure, rather like the existing informal clearance process.

If ESC C16 cannot continue to operate unchanged, the only options would seem to be to legislate or withdraw the concession completely. It seems (to me, at least) that HMRC would prefer the latter option. We shall have to wait and see.

4. Offshore Penalties

The first Finance Act of 2010 introduced a new penalty regime in respect of undisclosed offshore accounts, from a date to be appointed by Treasury Order. The publicity generated by this legislation resulted from a 'headline' maximum penalty rate of 200%. Many individuals, particular those with a foreign connection, have offshore accounts these days. In what circumstances can the enhanced penalty rates apply?

There are 3 categories of penalty under the new regime. Enhanced penalties apply to inaccuracies under categories 2 and 3 (the penalties under category 1 are up to 30% for 'careless', 70% for 'deliberate but not concealed' and 100% for 'deliberate and concealed' defaults).

The penalties for a 'category 2' inaccuracy are up to 45%, 105% and 150% respectively. For a 'category 3' inaccuracy, the penalties are up to 60%, 140% and 200% of the tax lost. These higher penalty rates depend upon the 'transparency' of the offshore jurisdiction concerned. They also reflect the fact that HMRC is less likely to detect non-compliance in those jurisdictions, and that the choice of jurisdictions may have been affected accordingly.

Penalty categories

A 'category 1' inaccuracy "involves a domestic matter" or "involves an offshore matter" (as defined) either in a 'category 1 territory' (i.e. broadly a territory which automatically exchanges information with the UK), or where the tax at stake is not

income tax or CGT. By contrast, a category 2 or 3 inaccuracy involves an offshore matter where the tax at stake is income tax or CGT, and the territory is a category 2 or 3 territory.

Territories are categorised by Treasury Order, broadly according to the following criteria (FA 2007, Sch 24, para 21A):

- The existence of information exchange arrangements for tax enforcement purposes between the UK and the other territory:
- The quality of such arrangements (i.e. whether information is exchanged automatically, or upon request); and
- The benefit to the UK of receiving information from that territory if such arrangements existed.

The penalty regime for failing to make returns etc (FA 2009, Sch 55) is also expanded in respect of the withholding of information, according to whether it is category 1, 2 or 3 information (as defined). In addition, amendments are made to FA 2008, Sch 41 ('Penalties: failure to notify and certain VAT and excise wrongdoing') to introduce category 1, 2 and 3 penalties in appropriate circumstances.

Offshore matters are broadly defined in terms of offshore income, assets or activities, or "anything having effect as if it were income, assets or activities" of those kinds. A 'domestic matter' is (not surprisingly) everything which is not an offshore matter.

The penalties of up to 200% mentioned above are subject to possible reduction based on the quality of disclosure to HMRC. For a category 3 penalty, where the 200% rate applies, the penalty cannot be reduced below 100% (for a prompted disclosure) or 60% (for an unprompted disclosure).

Alarm bells

HMRC has pointed out that there is nothing wrong with taxpayers having offshore accounts and sources of income or gains. However, there seems to be an

apparent suspicion of offshore evasion on a large scale. There is anecdotal evidence that some UK resident and domiciled taxpayers open accounts in 'tax havens' in the mistaken belief that the income generated somehow escapes tax in the UK.

Professional firms preparing tax returns may therefore need to educate some clients about the taxation of foreign income, as well as warning about the potentially high price of non-disclosure in terms of penalties.

Publications for 2010/11

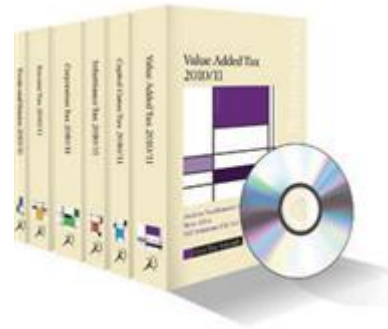


Tax Planning 2010/11

I am Editor and co-author of 'Tax Planning 2010-11', published by Bloomsbury Professional. The chapters I have written or co-written look at incorporation, company purchases of own shares, business property relief, and wills, variations and disclaimers.

Other chapters of the book include 'starting a business' by Rebecca Cave, 'disincorporating a business' by Partha Ray and 'tax planning for the non-resident and non-domiciled' by Robert Maas.

Tax Planning 2010-11 is updated to include the first and second Finance Acts of 2010. It is due for publication in September 2010. For further information and to order a copy of the book, visit: www.bloomsburyprofessional.com



Core Tax Annuals 2010/11

I am also the Editor of the Core Tax Annuals 2010/11, published by Bloomsbury Professional. I am co-author of the Inheritance Tax Annual 2010/11, which is part of the series. The titles in the Core Tax Annuals series are:

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