such as the accrued income scheme (1985: see 1378). Only when, in 1988, CGT rates were aligned with the basic and higher rates of income tax, and capital gains became taxed as the highest part of a taxpayer's income, did this kind of anti-avoidance lose much of its purpose. From 1999–2000, CGT rates were aligned with those for savings income so that gains in excess of the annual exempt amount were charged at 20% where the gains when added to total income were below the basic rate limit and 40% where they exceeded that limit. From 6 April 2008, CGT was payable at a flat rate of 18% (see 5410). In the June 2010 Budget, it was announced that a higher rate of tax was to be immediately introduced to reduce the gap between the existing 18% rate and the higher rates of income tax. Accordingly, a higher rate of 28% was introduced and applied in respect of disposals on or after 23 June 2010. The 28% rate replaced the 18% rate in respect of trustees and personal representatives and for individuals it applied in addition to the 18% rate; the actual rate applicable will be determined by the aggregate of the individual's taxable income and chargeable gains. In the March 2016 Budget, the rates were again cut in order to ensure that companies have the opportunity to access the capital needed to grow and create jobs as well as to promote a strong investment culture in the next generation. From 6 April 2016, there are two main rates of capital gains tax of 10% and 20% replacing the previous 18% and 28% rates, however, the 18% and 28% rates continue to apply for gains on residential property and carried interest. In addition, a special 10% rate applies to gains eligible for entrepreneurs' relief and, effectively, from the tax year 2019–20, the 10% rate will also be available to gains eligible for the new investors' relief introduced by *Finance Act* 2016.

Tax Reporter: ¶102-450

203 History of taxation on death

The notion of taxing a deceased person's estate is a long-standing one in the UK tax system. As a deceased's personal representatives are obliged to gather in all the property formerly belonging to him, the administration of an estate represents an ideal tax point.

The value attributable to the personal property comprised in an estate has been taxable since 1694, and from 1894, with the introduction of estate duty, broadly speaking, the entire estate of a deceased person has been subject to tax. Further, from 1965–1971, death was also the occasion of a charge to capital gains tax (CGT).

Estate duty was abolished upon the introduction of capital transfer tax (CTT) in 1975. Whilst CTT preserved the notion of taxing the estate of the deceased, it additionally introduced the novel concept of charging lifetime transfers of wealth cumulatively to tax. However, since *Finance Act* 1986, CTT has itself been replaced by inheritance tax, which retains the principal

features of CTT but is confined in its operation to the taxation of deceased persons' estates, transfers of capital made within seven years of death, and lifetime transfers into certain settlements. The inheritance tax represents in many ways a return to the estate duty system. The statutory provisions relating to inheritance tax are to be found in the *Inheritance Tax Act* 1984 (previously known as the *Capital Transfer Tax Act* 1984) as amended and supplemented by subsequent Finance Acts.

Tax Reporter: ¶600-000

204 Development of the taxation of companies

The *Joint Stock Companies Act* 1844 heralded the first of the statutory registered companies. This was superseded by the former *Companies Act* 1985 and now the *Companies Act* 2006. Notwithstanding this, no separate code of taxation for companies appeared until 1965 when corporation tax was introduced (although companies were previously subject to income tax and profits tax). The *Income and Corporation Taxes Act* 1988, as amended and supplemented, principally by parts of the Finance Acts receiving Royal Assent between 1988 and 1996, embodied the main corporation tax provisions.

Most of the provisions applying for corporation tax purposes have now been rewritten by the *Corporation Tax Act* 2009 and the *Corporation Tax Act* 2010. Many provisions dealing with international matters have been rewritten by the *Taxation (International and Other Provisions) Act* 2010. The enactment of the *Corporation Tax Act* 2010 and the *Taxation (International and Other Provisions) Act* 2010 effectively brought the Tax Law Rewrite Project to an end (see 200).

Tax Reporter: ¶102-400

205 The introduction of VAT

The UK joined what was then the European Economic Community in 1973. The treaty establishing the Community stated that one of its aims was the harmonisation of turnover taxes of member states. As a result, member states were encouraged to adopt a broadly common tax on value added. The UK's obligations in this respect were met with the introduction of VAT in 1973.

There have been a number of attempts to further harmonise the taxes that were introduced in each of the member states, but there remain considerable divergences, both in rates and in those items that are subject to charge.

Indirect Tax Reporter: ¶1-100

Giving effect to the charge to tax

Tax under the present provisions is charged on the employee or former employee, whether or not he or she is the recipient of the payment or other benefit. After the death of the employee or former employee, any outstanding charge is attached to his or her estate (as previously).

Reporting requirements

Employers must provide a report by the 6 July after the tax year in which any termination award is made. (This relaxes the previous requirement of a report within 30 days of the tax year end.)

For more details of the rules concerning ex gratia payments, see 422.

Legislation: ITEPA 2003, s. 401–404; *Income Tax (Pay As You Earn) Regulations* 2003 (SI 2003/2682); *The Tax and Civil Partnership Regulations* 2005 (SI 2005/3229)

Cases: *Colquhoun* [2010] TC 00348; *Moorthy v R & C Commrs* [2016] BTC 501; *Gedir* [2016] TC 04974; *Tottenham Hotspur Ltd* [2016] TC 05143

Tax Reporter: ¶437-000

428 The treatment of damages

An employee may commence or threaten legal proceedings for wrongful dismissal or breach of contract. Any payment made in settlement of such a claim is treated as a payment in compensation for loss of office and is chargeable as a specific termination payment, and the usual exemptions apply to it where appropriate (see 424).

Damages for wrongful dismissal or for breach of contract are to put the innocent party in the same position that he would have been in had the contract been carried out. In most instances, the employee would have been liable to tax on the payment. A deduction can accordingly be made to allow for tax from such payments so that the employee is in no better position than he would have been in had there been no breach of contract. This is known as the rule in *Gourley's* case.

Limitations to the Gourley rule

The following limitations to the *Gourley* rule should be noted:

- income tax is only deducted if such tax would have been deducted had there not been a breach of contract; and

- the damages, etc. themselves must not be the subject of a charge to tax.

In the case of damages for wrongful dismissal and breach of contract, the taxpayer would have paid tax on the payments as wages or salary if there had been no breach of contract, but such damages are charged to tax allowing the first £30,000 to be tax-free (see 424). The excess over £30,000, therefore, does not fall within the *Gourley* rule, whereas the first £30,000 does.

Case: *British Transport Commission v Gourley* [1956] AC 185

Tax Reporter: ¶437-000

Employee share schemes

430 Share incentives generally

All shares and securities acquired in connection with an employment come within the scope of the employment-related securities regime, including shares acquired by directors or employees on the formation of a company. The rules also extend to rights or opportunities to acquire securities, and to benefits in connection with shares and securities that are not otherwise chargeable to tax. They cover cases where the securities, or opportunities or rights to acquire the securities, are provided by a person other than the employer, and where the securities are not directly received by the employee.

In general, the treatment of remuneration received through shares and other forms of security follows the main principle that applies to other forms of remuneration such as cash and benefits. That principle is to charge to income tax and National Insurance contributions (NICs) the value that the employee receives as reward for his services at the time he has access to that value.

In deciding whether the employee has received reward for services in connection with securities, it is necessary to look at the extent to which, if at all, the employee has given consideration other than services. If, for example, the employee has paid the full market value for a simple share received from his or her employer, then there will be no employment reward and no charge to income tax and NICs on acquisition of the share. Any future normal commercial growth in the value of the share is within the capital gains tax regime.

Similarly, if an employee is given a free share as a reward for services, and pays income tax and NICs on the full value of that share, then the employee is exposed to exactly the same potential financial loss if the

1268 Short leases: lump-sum rents and surrender payments

Where, under the terms subject to which a 'lease' (see 1260) is granted, a sum becomes payable by the tenant in lieu of the whole or part of the rent for any period, that sum is deemed to be a premium and a notional rent arises when it becomes payable by the tenant. The lump sum or premium is treated as relating only to the period of the lease for which the payment was made in lieu of rent. The sum may thus be taxable to the extent which applies in relation to premiums generally under short leases (see 1264).

Example

A landlord grants a lease of 31 years. The lease provides that the landlord can demand a lump sum after ten years of £40,000 in lieu of rent for the remainder of the lease. The £40,000 is deemed to be a premium payable for a lease of 21 years (31 – 10).

Where, under the terms subject to which a lease is granted, a sum becomes payable by the tenant as consideration for the surrender of the lease (brought to an end by an agreement between landlord and tenant), that sum is deemed to be a premium and a notional rent arises when it becomes payable by the tenant. The premium is taken to be paid in consideration of the lease from the date of commencement to the date of surrender. The sum may thus be taxable to the extent which applies in relation to premiums generally under short leases (see 1264). If, however, surrender is agreed between landlord and tenant after the lease has commenced, the above provision will not apply and CGT only will be chargeable on the surrender payment.

Example

The landlord grants a lease for 31 years with a surrender clause and the tenant surrenders in accordance with the clause after ten years for the stipulated figure of £20,000. The £20,000 is treated as a premium applicable to the duration of the lease from commencement to surrender (i.e. ten years).

Legislation: ITTOIA 2005, 279–280

Tax Reporter: ¶300-130

1270 Short leases: payments to waive or vary the terms of the lease as income

Where a sum becomes payable by the tenant, otherwise than by way of rent, in consideration for a variation of any term of the 'lease' (see 1260), that sum is deemed to be a premium in the year when the contract

providing for the variation or waiver was entered into. The sum may thus be taxable to the extent which applies in relation to premiums generally under short leases (see 1264). The premium is treated as attributable to the period during which the waiver or variation is to have effect, i.e. the duration of the lease to which the variation or waiver applied. (Payments in point paid to a person other than the landlord are assessable only if paid to a person who in relation to the landlord is a 'connected person'.

Example

The landlord grants a lease of 31 years. Under the provisions in the lease, the tenant has an option to take a further term provided he observes all the conditions of the lease. If the tenant fails to do so after ten years have elapsed but then pays the landlord £10,000 to waive his (the landlord's) right to object to a further term being taken, that £10,000 would be treated as a premium attributable to that period of the lease over which the variation or waiver occurred, i.e. 21 years.

Legislation: ITTOIA 2005, s. 313(5)

Case: *Banning v Wright (HMIT)* [1972] 1 WLR 972

Tax Reporter: ¶300-140

1274 Short leases: sale proceeds as income where right of reconveyance

In addition to the anti-avoidance provisions relating to the duration of the lease (the lease term for tax purposes being determined in a specific way: see 1262), there are also provisions designed to prevent specific avoidance schemes in connection with leasebacks (see 1276) or reconveyances (see below).

Where the terms subject to which an estate or interest in land is sold provide that it shall be, or may be required to be, reconveyed at a future date to the vendor or a person 'connected' with him, the vendor may be chargeable to tax under ITTOIA 2005 (or the sum may be treated as received as income of a property income business). The charge is on any amount by which the price at which the estate or interest is sold exceeds the price at which it is to be reconveyed, or, if the earliest date at which in accordance with those terms it would fall to be reconveyed is a date two years or more after the sale it is discounted in accordance with the provisions taking only a portion of premiums as income (see 1264).

Where the terms of the sale do not stipulate a date for reconveyance and the price varies with the date of reconveyance, the price of the reconveyance is taken to be the lowest possible under the terms of the sale. The vendor may reclaim (up to six years after the reconveyance) that

Unlike the personal allowance, the married couple's allowance is not given as a deduction from total income. Instead, relief is allowed at the rate of 10% of the amount of the allowance by means of a reduction in the claimant's income tax liability.

The tax reduction is given at Step 6 of the income tax liability calculation.

Abatement

The married couple's allowance is subject to abatement where the claimant's 'adjusted net income' exceeds the income limit of £27,700 for 2016–17 (and 2015–16). It is always the claimant's income that determines the level of abatement (if any). This is so even if it is the other spouse or civil partner's age that has given entitlement to the higher level of relief. However, the married couple's allowance is only subject to restriction once the claimant's personal allowance has first been reduced to the standard level. The abatement process cannot reduce the married couple's allowance below a specified minimum amount. For 2016–17 (and 2015–16), that amount is £3,220. Any abatement utilised in reducing the claimant's personal allowance cannot also be used to reduce age-related married couple's allowance.

Election to transfer relief

In respect of couples who married before 5 December 2005, the married couple's allowance was allocated to the husband in the first instance. For those marrying or entering into a civil partnership on or after that date, the allowance is given initially to the spouse or civil partner with the highest income for the year. Married couples who married before 5 December 2005 may nevertheless elect to come within the new rules.

However, it is possible for the spouse or civil partner who would not otherwise be entitled to claim the allowance to make a unilateral election to claim a tax reduction of one-half of the minimum amount (ITA 2007, s. 47(1)). The election can only be made if that individual meets the following conditions:

- he or she has made an election that is in force for the tax year;
- makes a claim; and
- meets the residence requirement.

The effect of such an election is that the allowance due to the other spouse or civil partner is reduced by one-half of the minimum amount.

Example

Chris and John form a civil partnership in January 2011. John was born in 1932 and Chris was born in 1937. John is the civil partner with the highest income. For 2016–17, his income is £18,000. Chris unilaterally elects for one-half of the minimum amount of the allowance.

For 2016–17, Chris is entitled to an income tax reduction of 10% of £1,610 (being one-half of the minimum amount for that year of £3,220).

John is entitled to an income tax reduction of 10% of £6,745, being the allowance of £8,355 he would have been entitled to in the absence of an election, less the £1,610 transferred to Chris.

Joint claim for transfer of the entire minimum amount

The entire minimum allowance (£3,220 for 2016–17 and 2015–16) can be transferred to the other spouse or civil partner if a joint election is made. This is an all or nothing claim, no other permutations are possible (except where relief is unused).

For such a transfer to be made, the following conditions must be met:

- the parties to the marriage or civil partnership have made a joint election which is in force for the tax year;
- the individual who would not otherwise be entitled to the allowance makes a claim; and
- that person meets the requirements of the residence condition.

The effect of the election is that the minimum amount is transferred to the wife or lower earning partner (as applicable depending on the date of the union). That partner is then entitled to a tax reduction of 10% of the minimum amount. The allowance available to the husband or higher earning partner, as applicable, is reduced by the minimum amount.

Example

Albert and Flo got married on 1 January 2009. Albert was born in 1932 and Flo was born in 1937. For that tax year, Flo is the higher earning spouse, with income of £17,000.

Flo is entitled to claim a tax reduction in respect of the married couple's allowance as Albert was born before 6 April 1935 (both Albert and Flo were born before 6 April 1938). The allowance is £8,355 for 2016–17. As Flo's income is below the adjusted income limit, the allowance is not abated.

A joint election is in force for 2016–17 to transfer the minimum amount to Albert.

2095 Expenditure on research and development

Revenue expenditure on research and development is specifically allowed as a deduction from profits.

The expenditure must be related to the trade carried on. Broadly, this means it must benefit the trade, of those employed in it. It must be undertaken by the trader or carried out on his behalf. Specifically, excluded is expenditure on obtaining rights connected with research and development.

Subject to broadly the same conditions, especially as to the relevance of the research to the trade carried on, payments to scientific research associations and universities, colleges or similar institutions is also deductible.

Legislation: ITTOIA 2005, s. 87–88

Tax Reporter: ¶256-000

2098 Miscellaneous business expenses: deductibility

A number of common items, such as stationery, utilities, postage, etc. are allowable deductions if used wholly and exclusively for business purposes (where used partly for business, a fraction of the expenses may be allowed).

2101 Pre-trading expenditure

Expenditure incurred by a person for business purposes before the business commences is treated for income tax purposes as a trading loss incurred on the day trading starts (for relief, see 2104); the expenditure must not be incurred more than seven years before trading commences and must be such that it would have been allowable had trading commenced (see 2050). The time period in point was five years for those who started to trade before 1 April 1993.

HMRC's view is that pre-trading expenditure does not include costs incurred by persons other than the eventual trader.

Legislation: ITTOIA 2005, s. 57

Tax Reporter: ¶208-300

2104 Business losses: meaning for income tax

Business losses occur where allowable expenses exceed taxable receipts, and they may be relieved for income tax purposes in a variety of ways.

Under self-assessment, capital allowances are generally deducted as if they were a trade expense in arriving at the trading result (see 2324).

Where a person has made annual payments out of profits which have not been charged to income tax (see 1368) and those payments are wholly and exclusively for the purposes of a trade, profession or vocation, then the amount on which tax has been accounted for (see 1370) is treated as a loss sustained in the trade, etc. for 'carry-forward relief' (see 2107).

Allowable interest (see 1884) which exceeds available income, if laid out or expended 'wholly and exclusively' (see 2056) for the business purposes, is treated as a loss for the purposes of 'carry-forward relief' (see 2107) or 'terminal loss relief' (see 2122).

There is an extended right of offset against general income for opening years' losses (see 2119).

Restriction on income tax reliefs (from 2013–14)

From 6 April 2013, a cap applies to certain previously unlimited income tax reliefs that may be deducted from income under ITA 2007, s. 24 (FA 2013, s. 16 and Sch. 3). The cap is set at £50,000 or 25% of income, whichever is greater. The reliefs affected by the cap are as follows:

- ITA 2007, s. 64 (trade loss relief against general income);
- ITA 2007, s. 72 (early trade losses relief);
- ITA 2007, s. 96 (post-cessation trade relief);
- ITA 2007, s. 120 (property loss relief against general income);
- ITA 2007, s. 125 (post-cessation property relief);
- ITA 2007, s. 128 (employment loss relief against general income);
- relief under ITA 2007, Pt. 4, Ch. 6 (share loss relief);
- relief under ITA 2007, Pt. 8, Ch. 1 (interest payments);
- ITEPA 2003, s. 555 (deduction for liabilities relating to former employment);

Type of expense or benefit provided	Circumstances	Class 1 NICs due (include in gross pay)	Class 1A NICs due
Training payments for course fees, books and so on	training is work-related or encouraged or required by employer in connection with the employment	No	No
	all other circumstances and employer contracts[5]	No	Yes
	all other circumstances and employee contracts[4]	Yes	No
Vans available for commuting and other private use	Other private use is more than insignificant	No	Yes
Van fuel provided for use in vans available for commuting and other private use	Any means of supply. Other private use is more than insignificant	No	Yes [11]
Vouchers	see booklet *CWG2* for exceptions	Yes	No

Notes

[1] Not in use

[2] Where an employee purchases goods or services including car fuel on employers behalf, and employer transfers ownership of these to the employee, Class 1A NICs will be due.

[3] Not in use

[4] Contract is between the employee and the provider. The employer pays the provider or reimburses the employee. Payments to the provider should be returned on the P11D as shown. Reimbursements to the employee are subject to PAYE and do not need to be returned on the P11D. These payments are simply meeting the employees debt and are therefore liable for Class 1 NICs.

[5] Contract is between you, the employer and the provider of the benefit.

[6] Specific and distinct business expenses may feature in a number of payments employers make to employees and should be recorded in the appropriate P11D section.

[7] There is no limit to the number of mobile phones that may be provided NICs free solely for business use and on which private use is not significant. Only one mobile phone per employee may be provided NICs free for private use. No mobile phone may be provided NICs free to a member of an employee's family or household. See *Employment Income Manual* EIM21778.

[8] Expenses which are not exempt are any expenses not included in the list of booklet 480 (2016). The employer will need to return on the P11D any amounts that the employee should have paid, but that the employer paid instead.

[9] Details of what constitutes exempt expenses and benefits are described in booklet 480 (2016).

[10] Round sum allowances may feature in a number of payments employers make to employees and should be recorded in the appropriate P11D section.

[11] Class 1A NICs are not due if the van:

- is available to the employee for business travel and commuting;
- is not used for any other private purpose except to an insignificant extent; and
- is available to the employee mainly for use for the employee's business travel.

The *Income Tax (Earnings and Pensions) Act* 2003, s. 320C provides an exemption from income tax of up to £500 per employee per tax year, where an employer funds recommended medical treatment, subject to certain conditions (see 293). Such payments are also exempt for NIC purposes from 1 January 2015.

Legislation: *Social Security (Contributions) (Amendment No. 6) Regulations* 2014 (SI 2014/3228)

2663 Cars

A car provided by reason of employment to a director or an employee (or for tax years up to 2015–16, employees earning at the rate of at least £8,500 p.a.), which is available for private use, attracts a Class 1A liability, as does the provision of any fuel for private use in such cars. There are special rules for Class 1A NICs for cars provided in unusual circumstances.

Detailed guidance on the Class 1A liability arising in respect of company cars and car fuel is given in HMRC booklet CA33, *Class 1A National Insurance contributions on car and fuel benefits*, available from the employer's orderline (0300 123 1074) or to download from the HMRC website.

In *Southern Aerial (Communications) Ltd*, Mr and Mrs Jones had structured their business so that their cars were provided by their partnership but via a recharge of costs from their company. The FTT held that the cars were provided by the company and, accordingly, by reason of the directors' employment and were, therefore, subject to Class 1A NICs.

More than one employment

A person may have two or more concurrent but independent employments: e.g. working four days per week for company C and one day per week for company D. If both C and D make available a company car *and* pay earnings, both have a Class 1A liability if the employee is a P11D employee (see 403). However, if C were to pay earnings but not provide a company car, while D paid no earnings whatsoever but made available a company car for private use, neither would have a Class 1A liability, provided it could be shown that the car was not made available by D by reason of the employment with C, and that the payment of salary by C was unconnected with the employment by D. However, it should be noted that a payment of £1 of earnings by D would make D liable to Class 1A contributions.

Where a company with investment business also has a UK property business, and it ceases to carry on that property business, any unrelieved loss is treated as an expense of management of the succeeding accounting period.

As with trading losses (see 3315), loss relief is only available for a UK or overseas property business conducted on a commercial basis or in the exercise of statutory functions.

Legislation: CTA 2010, Pt. 4, Ch. 4

Tax Reporter: ¶730-650 and ¶730-700

3350 Losses from miscellaneous transactions (formerly losses under Sch. D, Case VI)

A company which makes a loss on a miscellaneous transaction can offset that loss against the earliest available miscellaneous income (being income chargeable under CTA 2010, s. 1173 with the exception of offshore income gains), whether in the same or subsequent accounting periods. A transaction is a miscellaneous transaction if, had it given rise to income, that income would have been chargeable to corporation tax as miscellaneous income.

Legislation: CTA 2010, s. 91

Tax Reporter: ¶730-800

3355 Capital losses of companies

Allowable capital losses can only be set against chargeable gains of the same or subsequent accounting periods. Losses must be set against current period gains before future gains. The set-off is mandatory. Losses must be set against gains at the earliest opportunity.

Example

A company makes a chargeable gain of £100,000 and an allowable loss of £175,000 in the year to 31 March 2012. In the year to 31 March 2013, it makes a chargeable gain of £250,000.

The allowable loss of £175,000 is first set against the gain of the same accounting period so as to reduce net gains to nil. The balance of £75,000 is then set against the gain for the year to 31 March 2013, leaving net gains of £175,000 to be included in the company's profits chargeable to corporation tax for that period.

Allowable capital losses cannot be set against trading profits.

Targeted anti-avoidance rules (TAARs) were introduced with effect from 5 December 2005 to prevent the avoidance of tax through the creation and use of capital losses by companies. The legislation is targeted specifically at the following three areas of avoidance:

(1) the contrived creation of capital losses;

(2) the buying of capital gains and losses; and

(3) the conversion of income to capital and using capital losses to create a deduction against income.

From 21 March 2007, new legislation prevents schemes that exploited an exception in existing anti-avoidance rules. Broadly, the new measures are intended to prevent groups of companies obtaining a tax advantage where a company changes ownership (see 3375) and one of the main purposes of the arrangements is for the new owners to gain access to the company's capital losses or gains.

HMRC have provided reassurance that the legislation will not apply where there is a genuine commercial transaction that gives rise to a real commercial loss as a result of a genuine commercial disposal.

Legislation: TCGA 1992, s. 8, 16A and 184A–184I

Tax Reporter: ¶753-150ff.

Particular situations

3370 Change of trader without change in ownership

If a company (C) stops trading and a second company (S) starts to carry on the same trade, and the shareholders who held 75% (or more) of the ordinary share capital of C within one year before the change hold 75% (or more) of the ordinary share capital of S within two years after the change, C and S are treated as one company when calculating the capital allowances and losses of the trade in so far as S is entitled to reliefs to which C would have been entitled.

It is the activity of C, rather than the trade as such, which must be carried on by S.

Loss relief is restricted where the predecessor company is insolvent at the time it ceases to carry on the trade or part of a trade. Where the predecessor company's 'relevant liabilities' exceed its 'relevant assets', the entitlement of the successor company to the predecessor company's losses is restricted to the excess of the losses over the amount by which relevant liabilities exceed relevant assets.

- certain demergers (see 3830);
- certain purchases by a company of its own shares (see 3850).

If one company transfers assets or liabilities to another company, it will not be treated as a distribution if both companies are resident in the UK and neither is a 51% subsidiary of a foreign company and they are not under common control (see 3610) or if both companies are UK resident and one is a 51% subsidiary of the other or both are 51% subsidiaries of another UK resident company.

A distribution does not occur where fully paid preference shares are repaid and those shares existed on 6 April 1965 or were issued after that date for new consideration not derived from ordinary shares and remain fully paid until the date of repayment.

Legislation: CTA 2010, Pt. 23, Ch. 3

Tax Reporter: ¶743-600 and ¶743-800

Demergers

3830 Demergers which are not distributions

A 'demerger' is a transaction whereby trading activities carried on by a single company or group are divided so that they are carried on by two or more companies not belonging to the same group or by two or more independent groups.

If a company makes a distribution to facilitate a demerger, that distribution is exempt from the usual tax treatment and it is an 'exempt distribution' (see 3810). However, this exemption is hedged by numerous conditions and exclusions which must be considered at some length to acquire a full understanding of its application. There is a corresponding chargeable gains deferral for the shareholders.

Conditions for exemption

A distribution will not qualify for exemption unless it is one of the following.

(1) A distribution consisting of a transfer of shares by a company to all or any of its members of shares in one or more companies which are its 75% subsidiaries. The shares must be irredeemable and constitute the whole or substantially the whole of the distributing company's holding of the ordinary share capital of the subsidiary. The distribution must confer the whole or substantially the whole of the distributing company's voting rights in the subsidiary. The distributing company must, after the distribution, be either a trading company or the holding company of a trading group. The latter condition does not apply where the transfer relates to two or more 75% subsidiaries of the distributing company and that company is dissolved without any net assets remaining after the distribution which are available for distribution in a winding up.

(2) A distribution consisting of the transfer by the distributing company to one or more other companies of a trade or shares in one or more companies which are 75% subsidiaries of the distributing company. Before this can apply:

(a) if a trade is transferred, the distributing company must either not retain any interest or retain only a minor interest in that trade;

(b) if shares in a subsidiary are transferred, they must constitute the whole or substantially the whole of the distributing company's voting rights in the subsidiary;

(c) the only or main activity of the transferee company after the distribution must be the carrying on of a trade or the holding of shares transferred to it;

(d) shares issued by the transferee company must not be redeemable, must constitute the whole of the issued ordinary share capital and must confer most of the voting rights in that company;

(e) the distributing company must, after the distribution, be either a trading company or the holding company of a trading group. This is not applicable if there are two or more transferee companies, each of which has shares in a separate 75% subsidiary of the distributing company transferred to it and the distributing company is dissolved without any net assets available for distribution in a winding-up after the distribution.

Further conditions require the distributing company, its subsidiaries and the transferee companies to be 'UK-resident' (see 214) at the time of the distribution and a subsidiary whose shares are transferred to be either a trading company or the holding company of a trading group at that time.

For distributions made on or after 11 November 2009, this requirement is replaced with a requirement that the companies must be resident in an EU member state (*Corporation Tax (Implementation of the Mergers Directive) Regulations* 2009 (SI 2009/2797)).

The distribution must be made wholly or mainly for the purpose of benefiting some or all of the trading activities which before the distribution are carried on by a single company or group and after the distribution will be carried on by two or more companies or groups.

To obtain MEAs, the taxpayer must carry on a 'trade of mineral extraction', i.e. a trade which consists of or includes the working of a 'source of mineral deposits', including exploration and gaining access thereto or restoration within a three-year period thereafter. A 'source of mineral deposits' includes a mine, an oil well and a source of geothermal energy. Pre-trading expenditure is subject to special rules.

With effect in relation to claims made on or after 1 April 2014 (corporation tax) or 6 April 2014 (income tax), *Finance Act* 2014 includes legislation which aligns the treatment of MEAs with the existing principles for plant and machinery allowances and confirms that for the purposes of MEAs a mineral extraction trade consists of activity within the charge to UK tax. *Finance Act* 2014 also amends the legislation to confirm that activity of an exempt foreign permanent establishment (FPE) is treated as a separate mineral extraction trade for the purposes of MEAs and to confirm that notional allowances will be given automatically in calculating the profits or losses of the exempt FPE as if the exempt FPE were within the charge to UK tax (with effect in relation to elections under CTA 2009, s. 18A which start to have effect on or after 1 April 2014).

'Qualifying expenditure' is capital expenditure on:

- mineral exploration and access;
- the acquisition of a mineral asset;
- construction of works which, when the source is worked out, are likely to have little or no remaining value;
- construction of works in connection with a foreign concession, which are likely to have no value to the trader when the commission ends; and
- certain capital contributions to the cost of foreign works for the provision of utilities or facilities for employees and their dependants.

In order to be 'qualifying expenditure', the capital contributions must be incurred for the purposes of the claimant's trade of mineral extraction and the utilities or facilities must be likely to have little or no residual value to the business. With effect from 17 July 2014, expenditure incurred on seeking planning permission will qualify as expenditure on mineral exploration and access whether the planning permission is successful or not. Previously, where planning permission was granted, the expenditure was treated as acquiring a mineral asset and eligible for relief at the lower rate of 10%.

Limitations on qualifying expenditure

Where an allowance is claimed in respect of a mineral asset and that expenditure includes expenditure on the acquisition of an interest in land,

so much of the expenditure as represents 'undeveloped market value' of the interest in land does not constitute qualifying expenditure. Similar provisions apply to exclude the 'undeveloped market value' of the interest from disposal receipts.

The allowances available to the trader ('the buyer') are restricted where they are claimed in respect of assets previously owned by another trader, whether or not that trader was entitled to an allowance in respect of their qualifying expenditure. If the previous trader was entitled to an allowance, then the buyer's qualifying expenditure cannot exceed the residue of the previous trader's qualifying expenditure. If the previous trader was not entitled to an allowance or the previous owner did not carry on a mineral extraction trade, then the buyer's qualifying expenditure cannot exceed the amount of the previous trader's qualifying expenditure or the previous owner's overall expenditure.

Where a mineral asset is transferred from one company to another company within the same group, the transferee company's qualifying expenditure is limited to that of the transferor.

Specifically excluded from the definition of qualifying expenditure is the cost of certain land and expenditure ancillary to the mining function, except offices falling within a 10% de minimis limit.

Allowances and charges

For the chargeable period in which the qualifying expenditure is incurred an allowance may be claimed equivalent to the 'appropriate percentage' of the excess of qualifying expenditure over disposal receipts required to be brought into account.

For any subsequent period the allowance which may be claimed is equivalent to the 'appropriate percentage' of the excess of qualifying expenditure over the aggregate of allowances already given in earlier periods together with any disposal receipts required to be brought into account.

The 'appropriate percentage' is 25%, except in relation to expenditure on the acquisition of a mineral asset where the 'appropriate percentage' is 10%. Whatever the appropriate percentage, it is adjusted if the chargeable period is not one year in length.

The disposal value of any asset which ceases to be used for the purposes of the trade must be brought into account as a receipt.

Where disposal receipts and allowances previously given exceed qualifying expenditure (plus certain demolition costs) in any period a balancing charge will arise. Conversely, a balancing allowance

5323 Election for 1982 valuation on all assets

Prior to FA 2008, and still for companies, it was necessary for the necessity for the retention by taxpayers of to retain pre-1982 records and the complexity of tax computations were made on more complex by the alternative bases available. However, taxpayers could elect that their capital gains and losses on all assets held as at 31 March 1982 be calculated by reference to March 1982 values. Such an election would displace the operation of the exceptions to 1982 rebasing. From 6 April 2008, rebasing has been mandatory and this election is no longer applicable for individuals and trustees.

Special provisions determine the nature of the election for groups. Plant and machinery generally and certain mining or oil-related assets are excluded from the election.

An election made by a person in one capacity did not cover disposals made by him in another capacity. In this respect, HMRC have indicated that:

- a partner could make an election in respect of a disposal of his interest in partnership assets but it was not necessary for all partners to make elections; if an individual was a member of more than one partnership, a separate election was required for each; a separate election was required for assets held privately;
- where assets were otherwise held jointly, each individual's share or holding would be covered by an election made by him in his capacity as an individual;
- an election by a sole trader applied to business and private assets;
- an election by the single body formed by all the trustees of a settlement applied only to that one settlement.

Time-limit

Once made, an election was irrevocable and it had to be made by notice in writing to HMRC before 6 April 1990 or within two years after the end of the tax year within which the first relevant disposal was made or such later time as HMRC may have allowed. Simply submitting a computation which was based only on the 31 March 1982 value did not, in HMRC's view, in itself constitute a claim. For tax years after 1995–96, the time-limit was 12 months from the 31 January next following the tax year in which the disposal took place; that is, approximately 22 months from the end of the tax year.

A Revenue statement of practice clarified the operation of the time-limit for the rebasing election. The statement treated certain disposals which

would not produce chargeable gains as not being 'relevant disposals' and accordingly such disposals could be left out of account in timing any election. Disposals included were of private cars; chattels below the value of the chattel exemption; chattels which were wasting assets; government non-marketable securities; gilt-edged securities and qualifying corporate bonds; rights to compensation for an injury or wrong suffered by an individual in his person, profession or vocation; shares held as part of a personal equity plan, etc; life assurance policies, etc. unless purchased from a third party; foreign currency for personal expenditure; most debts held by the original creditor; BES shares in respect of which relief had been given and not withdrawn; gifts of works of art, etc; decorations for valour, etc; betting winnings and rights to certain superannuation allowances, annuities, etc.

In determining the time-limit for an election, HMRC would also omit those disposals which in practice did not give rise to a chargeable gain or allowable loss, the main examples being building society withdrawals, dwelling-houses where the whole gain qualified for private residence relief, most no gain/no loss provisions. Discretion would also be exercised so as to ignore disposals where no election for the simplified re-basing scheme was possible. The statement also gave guidance for persons who became resident in the UK after 6 April 1988, for disposals of non-UK assets by individuals resident but not domiciled in the UK and for disposals by a UK resident during a period of non-residence.

Legislation: TCGA 1992, s. 35(5)–(8) and Sch. 3, para. 7, 8

Other Material: SP 4/92

Tax Reporter: ¶520-400

Wasting assets

5330 Importance of 'wasting assets'

A 'wasting asset' is an asset with a predictable useful life of no more than 50 years as ascertainable at the time of acquisition. Thus, a lease granted for a term of no more than 50 years is a wasting asset (see further 5333). The following general rules apply:

- plant and machinery are in all cases wasting assets, even where the asset is considered to have a useful life of more than 50 years. HMRC have confirmed that they regard such items as antique clocks, vintage cars and sailing vessels propelled by engines as 'machinery' (see HMRC's *Capital Gains Manual* CG76900ff., which also gives a fuller list of specific items considered to be machinery);

are made outside the accounts (see 5785). However, there is a charge to tax when the transactions are not between persons at arm's length. Market value is substituted for any deemed or actual consideration for the disposal (see 5100ff.).

The transaction is not at arm's length if the parties are 'connected' (see 5130). Often transactions between existing partners will be bona fide commercial transactions and the market value rule will not apply. But market value is substituted where the partners are connected other than by partnership (e.g. father and son).

Market value is not substituted if nothing would have been paid if the parties had been at arm's length or if the sum paid would have been paid if the parties had been at arm's length.

Other Material: SP D12, *Partnerships*

Tax Reporter: ¶290-100

Gains of special taxpayers

5800 Charities, local authorities, health service bodies, public institutions

Gains accruing to charities are exempt from taxes on chargeable gains if they are applicable and applied for charitable purposes only; in this regard, the exemption may be restricted to the extent that the charity incurs non-qualifying expenditure, as in relation to income tax. Gains accruing to trustees under a will have been held not to be exempt from CGT, although charities were among the residuary beneficiaries. However, donations from one charity to another (giving rise to capital gains) may be exempt from CGT although the recipient charity merely adds the donations to its general funds and does not distribute them.

If property ceases to be held for charitable purposes (including where the charity ceases to be a charity), there is a deemed market value disposal which is not exempt; further, if that property was acquired on a disposal of other assets held on charitable trusts the previous exemption for that disposal is lost.

There is no charge to CGT where a charity or any of a list of specified public benefit bodies becomes absolutely entitled to settled property as against the trustees (see 6189).

Local authorities, local authority associations and health service bodies are also exempt from tax on capital gains.

There are also exemptions for the Crown, the Treasury, etc. various museums and other public institutions, for consular officials, and for the issue departments of the central banks of India and Pakistan.

Legislation: TCGA 1992, s. 256(1), 271(1)(a), (f), (5)–(8)

Case: *IR Commrs v Helen Slater Charitable Trust Ltd* (1981) 55 TC 230

Other Material: Former ESC D47, *Temporary loss of charitable status due to reverter of school and other sites*

Tax Reporter: ¶589-100; ¶815-440

5803 Scientific research associations

Scientific research associations within the definition in CTA 2010, s. 469 are exempt from CGT, although a claim must be made for exemption.

Legislation: TCGA 1992, s. 271(6)(b)

Tax Reporter: ¶589-650

5810 Lloyd's underwriters

Annual deemed gains or losses on assets forming part of a Lloyd's underwriter's premiums trust fund or special reserve fund are subject to income tax as part of the proceeds of a trade of insurance, as are any gains/losses arising from actual disposals of those assets.

Other fund assets are subject to CGT in the usual manner, the member being treated as absolutely entitled to the assets.

Individual members of Lloyd's who participate in syndicates through a Members' Agent Pooling Arrangement (MAPA), can to treat their share of the various syndicate capacities held through the MAPA as if it were a single direct holding of syndicate capacity, so reducing the number of CGT computations needed when the MAPA manager buys and sells syndicate capacity or when other members join or leave the MAPA. Further, all syndicate capacity, whether held directly or through a MAPA, is eligible for CGT rollover relief on acquisitions or disposals.

Legislation: FA 1993, s. 176(1), Sch. 20A; FA 1999, s. 82, 83

Tax Reporter: ¶588-300; ¶588-550

Legislation: TMA 1970, s. 46D; SI 1967/149

Other Material: HMRC: *Litigations and settlement strategy*

Tax Reporter: ¶190-390ff.

Collection of CGT

6470 Collection of CGT generally

The rules applicable to the payment of capital gains tax and the charging of interest and surcharges are the same as those applicable to income tax (see 2350ff.).

If the taxpayer cannot make payment, they should contact HMRC's Business Payment Support Service before the payment deadline, to see whether it is possible to be given time to pay.

If the taxpayer does not make payment, HMRC have a number of methods of recovery open to them including collection through PAYE, taking control of goods, magistrates court proceedings, county court proceedings and insolvency proceedings.

Date of payment

Capital gains tax for any tax year is due (in accordance with a person's self-assessment or HMRC's calculation thereof on his behalf) on 31 January which is ten months after the end of the tax year or, if later (provided he notified HMRC of his chargeability within six months of the end of the year), three months from the issue of the notice requiring him to make a return of his income or gains. There are penalties for late payments, and interest runs on overpayments and underpayments from the due dates (see 2368 and 6484). Additional tax payable as a result of an amendment to the self-assessment figure becomes due as above or, if later, 30 days from the notice of the amendment. Further tax payable if HMRC make a 'discovery assessment' (see 2330) is due 30 days from the notice of assessment.

Autumn Statement 2015 announced that from April 2019, a payment on account of any CGT due on the disposal of residential property will be required to be made within 30 days of the completion of the disposal. This will not affect gains on properties which are not liable for CGT due to Private Residence Relief. The Government will publish draft legislation for consultation in 2016 (Finance Bill 2017).

NRCGT liabilities

Payment on account of capital gains tax to be made for a tax year when an NRCGT return contains an advance self-assessment for the year (see 6428A). The amount payable is the difference between the amount notionally chargeable in relation to the return and the payments (if any) made towards that amount. Payment is due on the filing date for the return (i.e. within 30 days of completion).

Individuals within self-assessment are not required to make payment until the normal due date for the tax year as set out above (but have the option to make payment on filing the NRCGT return).

Payment by instalments of CGT on gifts

Tax can be paid in ten equal annual instalments where there is a disposal by way of gift or a deemed disposal on a beneficiary becoming absolutely entitled against the trustees of a settlement, or a deemed disposal on the termination of a life interest on death. The disposal must also be one to which the relief for gifts of business assets or the relief accorded for gifts on which inheritance tax is chargeable in various circumstances does not apply, or would not apply were a claim made. The first instalment is due on the day on which, had the tax been payable normally, it would have been payable; however, tax payable by instalments carries interest from the normal due date so that each instalment is increased to reflect the interest element. A taxpayer wishing to pay off outstanding instalments not yet due may do so at any time, though interest is payable up to the date of settlement.

Legislation: TMA 1970, s. 59AA, 59B; TCGA 1992, s. 281

Tax Reporter: ¶182-750; ¶183-000; ¶183-025

6474 Recovery of CGT from person not primarily liable

A number of provisions enable CGT to be collected from someone other than the person primarily liable for the tax (see below).

Settlements

If CGT assessed on the trustees of a settlement is not paid within six months of its becoming payable and before or after the six-month period, the asset on which the gain arose or the proceeds of sale from it is transferred to someone, who is absolutely entitled to it as against the trustees, the recipient can be assessed to the tax, or a proportion of it, within two years of the tax becoming payable (see 5600).

7174 Grant of tenancies of agricultural property

Where it is not specifically provided otherwise, the grant of an agricultural tenancy would result in a transfer of value because of the ensuing reduction in the value of the freehold. Accordingly, it is provided that the grant of a tenancy of agricultural property in the UK, the Channel Islands or the Isle of Man for use for agricultural purposes is not a transfer of value by the grantor (see 7150) if he makes it for full consideration in money or money's worth.

Legislation: IHTA 1984, s. 16

Tax Reporter: ¶610-950

7176 Changes in distribution of deceased's estate

Certain changes in the distribution of a deceased's estate are not transfers of value (see 7150):

- a variation or disclaimer made within two years of death (see 6805);
- the renunciation (in Scotland) to a claim to legitim within a specified period (see 6805);
- a transfer within two years of death in accordance with a testator's express wish (but not under the terms of his will) (see 7023); or
- an election by a surviving spouse to have his or her life interest redeemed where the deceased died intestate (the survivor thereafter being regarded as entitled to the capital value).

Note that a review of instruments of variation was announced in the March 2015 Budget to establish if they are being used for tax avoidance purposes with a government response expected as part of the 2015 Autumn Statement.

Legislation: IHTA 1984, s. 17, 145

Other Material: *HMRC Inheritance Tax: Customer Guide* available on the HMRC website at www.hmrc.gov.uk/cto/customerguide/page1.htm

Tax Reporter: ¶611-000

Transfers exempt during life and on death

7192 Transfers between spouses and civil partners

Generally, direct transfers between spouses and civil partners are exempt without limit, both during lifetime and on death even where the couple is

not living together (but if not living together the CGT exemption may not apply). Where the transferor is domiciled in the UK, but their spouse or civil partner is not, the exempt amount was restricted to a lifetime total of £55,000 until 5 April 2013. However, FA 2013, s. 178 increased the foreign domiciled spouse exemption to an amount equivalent to the current nil-rate band of £325,000 but this remains a lifetime allowance. This change will apply to deaths on or after 6 April 2013 (with an indication that for the future the relief will match any future increases in the standard nil-rate band).

The increase only applies to transfers of value made on or after 6 April 2013. So, for a period, if domiciled/non-domiciled partners had previously tried to manage their IHT liability by lifetime gifts then before 5 April 2013, there was only the £55,000 limit with any excess deducted from the standard nil-rate band (or any transferrable nil-rate band but on death only) as a PET whereas gifts made on or after 6 April 2013 will be exempt provided they do not exceed £325,000.

Example 1

Tony (UK domiciled) is in a civil partnership with Alfredo (who is Spanish domiciled) and in November 2012 he made a gift of £100,000 to Alfredo. He subsequently made a further gift of £150,000 to Alfredo on 1 August 2013. In respect of the first gift, the excess of £45,000 above £55,000 used up part of the available nil-rate band of Tony but the second gift will be covered by the inter-spouse/civil partner limit of £325,000 (£120,000 remains – £325,000 – £55,000 – £150,000).

Unlike the normal nil-rate band, the limit on transfers to a non-domiciled spouse/civil partner is not refreshed after seven years and where the £55,000 has already been used the transferor will then only have, post-5 April 2013, £270,000 available. In the above example, the post 5 April 2013 increase to £325,000 cannot make the £45,000 PET in November 2012 an exempt gift because the transfer was before the law changed but if Tony survives beyond November 2019 (and the £45,000 was the only gift that reduces the nil-rate band) then the standard nil-rate band would be refreshed.

It follows that once any 'transitional' arrangements have worked their way through that a UK domiciled spouse/civil partner could potentially transfer a total of up to £975,000 (at current nil-rate band) to a non-domiciled spouse/civil partner without any IHT liability arising. That being the aggregate of non-domiciled spouse/civil partner exemption of £325,000, the conventional nil rate band of £325,000 and a full transferrable nil-rate band available on the death of a previous spouse/civil partner.

Example 2

Andrew gave his wife, Beth, £500,000 in September 2012. They are both domiciled in the UK. There will be no IHT charge on this transfer of value.

The main occasions when the special rules apply are:

- deemed supply when goods or services are put to non-business use;
- deemed supply on import of services;
- compulsory purchase of land, or supply of it when amount of consideration undetermined;
- supply under a major interest lease;
- supply of power, heat, etc.;
- supply involving retention payments;
- continuous supplies of services;
- royalty payments, etc.;
- certain supplies in the construction industry;
- deemed supply on transfer of a going concern to partially exempt group; and
- self-supplies.

Change in rate of tax: consequences

If there is a change in tax rate, or in the liability status of a supply, and the basic tax point falls under one set of rules while the tax point finally determined falls under the other set of rules, the supplier may elect to treat the supply as taking place at the basic tax point. This applies only for determining the rate of tax for the supply. The ordinary tax point is used for all other purposes, such as determining when the tax is payable to HMRC.

If, as a result, it transpires that a tax invoice already issued now bears an excessive amount of tax, the supplier must issue a credit note to reduce the tax within 45 days after the change.

The option to elect for the most favourable tax point does not apply in the case of self-supplies of cars, or in the case of goods sold by a receiver.

The ability to select the most favourable tax point, and therefore rate of VAT, applies to users of the cash accounting scheme as well as to other traders. The cash accounting scheme only affects the date when tax is paid to, or reclaimed from, HMRC, not the underlying tax point.

Legislation: VATA 1994, s. 88, 88(6); *Value Added Tax Regulations* 1995 (SI 1995/2518), reg. 81–93

Other Material: Notice 700, *The VAT Guide*

Indirect Tax Reporter: ¶11-700, ¶12-305, and ¶12-500

Value of supply

7844 Introduction to value of supply

The value of a supply, as determined for VAT purposes, is the amount on which VAT is charged. Clearly, it is important to understand the rules for determining the value of a supply (or the 'taxable amount', as it is called in the EC legislation), since this directly affects the amount of tax chargeable.

As is the case with the law governing the time of supply, there are some basic rules which cover most transactions, and then a set of special rules which apply in specified circumstances.

Legislation: VATA 1994, s. 19(1)

Other Material: Notice 700, *The VAT guide*

Indirect Tax Reporter: ¶14-200

7846 Consideration in money

If a supply is made for consideration, and the consideration is wholly in money, the value of the supply (or taxable amount) is taken to be the amount which, with the addition of the tax chargeable, is equal to the consideration. In other words, if a supply is made for money, the price charged includes the VAT due.

So:

VALUE PLUS VAT = CONSIDERATION

From the supplier's point of view, it is therefore desirable to express the price as being a VAT exclusive amount, with VAT to be added as appropriate.

Example

Alfred sells standard-rated goods to Bert for £3,000.

If the contract price is stated as being VAT-inclusive, the VAT is £500 (1/6 × £3,000).

The value if the supply is therefore £2,500.00.

If the contract price is stated as being excluding VAT, the taxable value of the supply is £3,000 and the VAT is £600.00 (£3,000 × 20%).

Legislation: VATA 1994, s. 19(2)

Indirect Tax Reporter: ¶14-200

8374 Monthly payments on account by large traders

There are provisions under which certain businesses have to make monthly payments on account of their VAT liability during a prescribed accounting period, any underpayment or overpayment being settled when the return for the period is submitted.

Broadly speaking, this requirement affects businesses whose net VAT payments exceed £2m p.a. A first payment on account is required by the end of the month following the first month of a period, a second one a month later, the balance being cleared by submission of the return at the end of the month following the period end. The amount of each interim payment on account is one twenty-fourth of the estimated annual liability.

There is provision for escaping this requirement where, in a subsequent 12-month period, the net VAT liability falls below £1.6m.

Legislation: VATA 1994, s. 28; *Value Added Tax (Payments on Account) Order* 1993 (SI 1993/2001)

Other Material: Notice 700/60, *Payments on account*

Indirect Tax Reporter: ¶55-410

8380 Local authorities, government departments and similar entities

Local authorities are liable to be registered in respect of taxable business activities, whatever their level of turnover. Business activities of local authorities are taxed in the ordinary way, and input tax blocked in respect of exempt business activities.

As far as non-business activities of local authorities, and certain similar entities, are concerned no output tax is chargeable, but the local authority, etc. is entitled to reclaim input tax (VATA 1994, s. 33(1)).

The bodies to which this relief applies include such entities as local authorities, water authorities, port health authorities, police authorities, the BBC, etc. and any body specified in a suitable Treasury order. Local authorities include the council of a city, district, London borough, parish or group of parishes, etc.

Government departments are treated slightly differently. They too will be bound by the normal VAT rules and may have to charge VAT on their non-statutory activities (their statutory activities are outside the scope of VAT). VAT charged to them may be recoverable under a special Treasury scheme under VATA 1994, s. 41.

Certain museums and galleries, which do not charge members of the public for admission, can claim a refund of input tax.

The input tax must be in respect of those supplies made to an applicable body that are attributable to the provision by that body of free rights of admission to a relevant museum or gallery. The Treasury may, by order, list applicable bodies and relevant museums and galleries for this purpose. Furthermore, HMRC will apportion the input tax where the bought-in supplies are attributable to both free admissions and other supplies.

Legislation: VATA 1994, s. 33(1), 33A(3), 41, 42

Indirect Tax Reporter: ¶51-000

8386 Retail schemes

In principle, VAT is due on each supply made, and should be computed separately for each supply. In order to save retailers from having to keep a detailed record of each sale made, retail schemes are available to them. Under these, a record is kept of daily gross takings (which includes credit sales). The output tax due is then calculated by estimating the proportion of takings which represent standard-rated sales and applying the VAT fraction to arrive at the VAT element contained therein.

Retailers with a turnover exceeding £10m p.a. cannot use a retail scheme without the specific agreement of HMRC, and other retailers may be refused the use of the scheme where it is practicable to account for VAT according to the normal rules.

Other Material: Notice 727, *Retail schemes* (May 2012); Notice 727/2, *Bespoke retail schemes*; Notice 727/3, *Retail schemes: How to work the point of sale schemes*; Notice 727/4 (January 2013 edn), *Retail schemes: How to work the apportionment schemes*; Notice 727/5, *Retail schemes: How to work the direct calculation schemes*

Indirect Tax Reporter: ¶45-000

8392 Second-hand goods schemes

Value added tax is intended ultimately to be collected at the retail stage of the supply chain. When a taxable supply is made by a trader to a final consumer, tax is accountable on the supply but cannot be recovered by the consumer. This works well for goods and services which are fully consumed by the consumer, but difficulties arise in the case of certain more durable goods which may pass back into the business system.

Under the basic VAT rules, if goods which have borne tax are sold by the consumer back into the business sector, then supplied again to

Payment of the duty must be made either by the 29th of the following month when payment is by direct debit/credit transfer, or otherwise by the 22nd of the following month.

Special accounting schemes

HMRC have the discretion to prepare a scheme for an aircraft operator to calculate the extent of the connected flight, return journey, and any other of the exemptions from duty and of any consequent adjustments between the rates of APD to be applied, where there are, or would be, difficulties in obtaining or recording the information otherwise required in regard to the duty. At the heart of the complexity in determining APD liabilities for passengers is the connected-flights feature in the tax.

Connected flights

Many air passengers reach their destinations after a series of two or more flights in which they may have had to get from one intermediate airport to another, as well as having had to change aircraft. If such carriage is not to be taxed differently from single non-stop carriage from origin to destination, then mechanisms to connect separate intermediate flights in a journey are required.

Two rules are set out in the regulations by which successive flights can be connected so as to provide exemption for passengers transferring between flights within certain specified time-limits, and to identify, within these same limits, each passenger's final place of destination for determining which APD rate should apply.

The 'Case A rule' (domestic connections)

The Case A rule requires that the scheduled departure time of a UK domestic flight must be within six hours of the scheduled time of arrival of the preceding flight (extended for flights arriving after 1,700 hours overnight, or for early morning arrivals before 0400 hours, to a departure time no later than 1,000 hours) for the two flights to be treated as connected.

A flight from a particular airport cannot be connected using the Case A rule to a flight destined for this same (domestic) airport.

The 'Case B rule' (international connections)

The Case B rule requires that the scheduled departure time of an international flight must be within 24 hours of the scheduled time of arrival of the preceding flight for the two flights to be treated as connected.

A flight from an airport in a particular country cannot be connected using the Case B rule to a flight destined for an airport in this same country. This latter sustains the charging of APD on passengers, mainly businessmen and women, who are flying into the UK and returning all within 24 hours.

Worked examples

The following examples show how the tax works differently for two different passengers sitting on the single class morning flight from London's Gatwick airport to Newcastle.

Example – Passenger one

The first passenger has boarded this flight after arriving at London's Heathrow airport at the scheduled arrival time of 0645 on a flight from New York. His ticket shows Newcastle as his final destination on a trip from the USA. No APD is due on his departure from Gatwick since the connected flight exemption applies. The requirements of the Case A rule are met, since they do not demand that the connection is made at the same airport.

Example – Passenger two

The second passenger is returning home to Newcastle after a trip to London. She flew down on a flight to Heathrow airport two days earlier. Even though she has a 'return' ticket, APD will be due at the lower rate of £13 on her departure from Gatwick.

Upgrades

If passengers are upgraded from one class of travel to another and:

- the upgrade has been provided at no extra cost to the passenger;
- the agreement for carriage does not include the possibility of an upgrade; and
- there has been no change in the agreement for carriage,

a reduced rate of APD applies to those passengers.

If the possibility of an upgrade at no extra cost has not been previously advertised or offered to the passenger prior to the decision to upgrade them, HMRC would not consider the agreement for carriage to have been changed.