RPC

Tax update

February 2020

In this month's update we report on (1) HMRC's Venture Capital Schemes Manual; (2) the review into the off-payroll working rules; and (3) a briefing paper regarding retrospective taxation put before the House of Commons. We also comment on three recent cases relating to (1) the meaning of "structure" for the purposes of capital allowances; (2) an HMRC challenge to carry-back loss relief claims; and (3) principal private residence relief.

News items

HMRC updates its Venture Capital Schemes Manual

On 27 November 2019, HMRC amended its Venture Capital Schemes Manual pages (VCT qualifying holdings: financial health requirement (VCM55050) and SEIS: income tax relief: issuing company: financial health requirement (VCM34060)), updating its guidance on the financial health requirement for Venture Capital Trusts and the Seed Enterprise Investment Scheme, set out in sections 286B (VCT) and 257DE (SEIS), Income Tax Act 2007 (ITA 2007), to bring it in line with EU guidelines. more›

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Retrospective taxation

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Case reports

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In *HMRC v SSE Generation Ltd* [2019] UKUT 332 (TCC), the Upper Tribunal (UT) has dismissed HMRC's appeal against the decision of the First-tier Tribunal (FTT) that the taxpayer was eligible for capital allowances in relation to certain expenditure it incurred in connection with the construction of the Glendoe Hydro Electric Power Scheme. more›

Any comments or queries?

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About this update

Our Tax update is published on the first Thursday of every month, and is written by members of RPC's Tax team.

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Knibbs – HMRC's challenge to carry-back loss relief claims was correct

In *Knibbs and ors v HMRC* and *R (oao Astley and ors) v HMRC* [2019] EWCA Civ 1719, the Court of Appeal has held that Schedule 1B, Taxes Management Act 1970 (TMA), can apply to a claim for carry-back loss relief. more>

Higgins – for the purposes of PPR relief "period of ownership" starts on completion

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On 27 November 2019, HMRC amended its Venture Capital Schemes Manual pages (VCT qualifying holdings: financial health requirement (VCM55050) and SEIS: income tax relief: issuing company: financial health requirement (VCM34060)), updating its guidance on the financial health requirement for Venture Capital Trusts and the Seed Enterprise Investment Scheme, set out in sections 286B (VCT) and 257DE (SEIS), Income Tax Act 2007 (ITA 2007), to bring it in line with EU guidelines.

The financial health requirement provides that, at the date of the investment, the investee company must not be "in difficulty", which is defined in ITA 2007 by reference to the Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty (the original guidelines), from 2004.

However, the original guidelines were superseded in 2014 by the Guidelines on State Aid for Rescuing and Restructuring Non-Financial Undertakings in Difficulty (2014/C 249/01) (the new guidelines) and the legislation is yet to be updated to reflect this. Nonetheless, HMRC has confirmed that it will apply the definition in the new guidelines when assessing whether a company is in difficulty and that it will regard any company as being in difficulty when:

- the company meets the criteria for insolvency under the Insolvency Act 1986
- more than seven years have elapsed since the company's first commercial sale and more than half of its subscribed share capital, including the share premium account, has disappeared as a result of accumulated losses.

The Enterprise Investment Scheme (EIS) page in the manual was previously amended to reflect this.

Investments made for the issue of shares are subject to strict rules under EIS and SEIS. In particular, the point at which the investments must be made in order to qualify for relief should be strictly observed. Advance subscription agreements (ASAs) are often used when companies wish to raise funds quickly under the EIS or SEIS as part of a funding round, or if advanced assurance is requested by investors. An investor will pay money under the terms of the ASA; but the shares are issued at a later stage, for example, on a funding round. A difficulty can arise in balancing investor protections (which can often be substantial) against the needs of the company.

HMRC's guidance sets out what is necessary for an ASA to qualify for EIS or SEIS relief on the issue of shares. Examples include the following:

- the ASA must not function as a loan agreement or an investment agreement which offers investor protection. HMRC expects that the company will demonstrate how the timing and terms of the ASA fit with its business plan
- there should be no provision for refunding the payment and it should not be possible to vary, cancel or assign the agreement
- the ASA must have a longstop date which HMRC expects to be no longer than six months from the date of the ASA.

HMRC expects a company wishing to obtain advance assurance to do so before entering into an ASA. In practice, investee companies will need to carefully consider the timing and terms of ASAs. Companies will also need to consider the timing of any advance assurance application.

The Venture Capital Schemes Manual can be viewed here.

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Review of off-payroll working rules launched

On 7 January 2020, the government launched a review of changes to the off-payroll working rules, known as IR35, which aims to address increasingly vocal concerns regarding how they will be implemented.

The reforms are due to come into force on 6 April 2020 and the review will determine whether any further steps should be taken to ensure successful implementation and whether any additional support is required to ensure that the self-employed are not impacted, as they are not within the scope of the rules.

The terms of the review can be viewed here.

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Retrospective taxation

On 23 January 2020, the House of Commons published a report into the circumstances in which retrospective legislation can and has been used to counter perceived tax avoidance. The paper addresses debates regarding the use of retrospective changes in tax law, particularly in relation to section 58, Finance Act 2008 and the 2019 Loan Charge.

The paper comments that In the Wealth of Nations, published in 1776, Adam Smith argued that a tax system should have four characteristics: equity, certainty, convenience, and efficiency. Smith defined the principle of certainty as follows: "the tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor and to every other person."

There remains a consensus that certainty is as important as it ever was in the design of the tax system. As the Office of Tax Simplification argued in a 2010 report: "taxes should not be arbitrary, the taxpayer should know his or her tax liability and when and where to pay it. It is important for a tax to be simple to understand, so that the taxpayer can calculate his or her liability."

Retrospective tax legislation overturns this principle. It imposes or increases a tax charge on income earned, gains realised or transactions concluded at some time prior to the legislation being introduced. Quite often governments have been willing to balance the need for certainty with the risks to the Exchequer from tax avoidance where taxpayers may be able to take action – forestalling – to avoid the impact of a change in the law before it can take effect. For many years governments have taken a consistent approach to the circumstances in which retrospective legislation can be used to counter perceived tax avoidance, an approach codified in 1978 in the so-called "Rees Rules".

In December 2004, the Labour government announced provisions to counter several schemes designed to avoid tax on employment income, and further to this Treasury Minister Dawn Primarolo made a written statement giving notice that the government would introduce retrospective legislation to tackle any similar avoidance schemes that came to light. At the time there was widespread consensus that the Primarolo Statement marked a major change in the revenue authority's approach.

The paper discusses the origin of the Rees Rules, and subsequent debates as to the use of retrospective changes in tax law, most recently in the context of the 2019 Loan Charge, which was introduced in the 2016 Budget and which has been widely criticised for being unfairly retrospective.

The briefing paper can be viewed here.

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Case reports

SSE Generation – UT considers the meaning of structure for the purposes of capital allowances

In *HMRC v SSE Generation Ltd* [2019] UKUT 332 (TCC), the Upper Tribunal (UT) has dismissed HMRC's appeal against the decision of the First-tier Tribunal (FTT) that the taxpayer was eligible for capital allowances in relation to certain expenditure it incurred in connection with the construction of the Glendoe Hydro Electric Power Scheme.

Background

SSE Generation Ltd (SSEG) claimed capital allowances in respect of £260 million of fixed asset expenditure in relation to the Glendoe Hydro Electric Power Scheme. HMRC accepted only £34 million of the claim and issued various closure notices to SSEG denying the remainder of SSEG's capital allowances claims in respect of the years ending 31 March 2006 to 31 March 2012, inclusive. SSEG appealed the closure notices.

The dispute related to works of civil engineering which enabled water to be taken into and from a dammed area and channeled under high pressure to the turbine to generate electricity, and for the used water to be discharged into Loch Ness. SSEG contended that the relevant assets were "plant" and that the relevant expenditure was expenditure "on the provision of plant", for the purposes of Part 2, Capital Allowances Act 2001 (CAA 2001).

FTT decision

The FTT decided that the expenditure incurred by SSEG on a considerable number of the relevant items was allowable, but that the expenditure on some of the items was not allowable. HMRC appealed to the UT against the FTT's findings in respect of the most substantial items.

UT decision

The appeal was dismissed.

It was common ground that:

(1) the expenditure in dispute was "qualifying expenditure" unless excluded by Chapter 3, Part 2, CAA 2001, and
(2) the expenditure was "on the provision of plant".

Section 22, CAA 2001, excludes from expenditure on the provision of plant and machinery, expenditure on (a) the provision of a structure or other asset in list B in section 22 (List B) (section 22(1)(a)), or (b) any works involving the alteration of land (section 22(1)(b)). Section 23 provides that sections 21 and 22 do not affect the question of whether expenditure on any item described in list C in section 23 (List C) is expenditure on the provision of plant or machinery.

The UT concluded that section 22(1)(a) and section 22(1)(b) are mutually exclusive and as a consequence a structure cannot fall within the scope of both provisions. The UT was of the view that the scope of section 22(1)(b) is limited to items of plant which result from works on the land without the creation of a "structure" or other similar asset and section 22(1)(b) applies where the alteration of land is the objective in its own right.

SSEG incurred expenditure on the provision of a structure which was not excluded by the operation of List B because it was an 'industrial building' saved by Item 7(a) of List B. The UT's conclusion meant that expenditure incurred on the construction of the industrial building, which entailed expenditure on works "involving the alteration of land", was not excluded by section 22(1)(b), and was therefore eligible for capital allowances.

The UT also concluded that the exception in Item 22 of List C for expenditure on the alteration of land for the purpose only of installing plant or machinery would apply where the relevant "plant" was excluded from allowances by virtue of being an Item in List B.

Comment

In contrast to many tax cases, this decision is an example of a purposive approach to legislation resulting in a decision which was favourable to the taxpayer. The UT narrowly interpreted the exceptions to the availability of capital allowances, which resulted in HMRC's appeal being dismissed.

The decision also clarifies the meanings of "tunnel" and "aqueduct" (as used in List B), and "installation" and "pipeline" as used in List C. This will be of assistance to other taxpayers. It is understood that HMRC are seeking permission to appeal the decision to the Court of Appeal.

A copy of the decision can be viewed here.

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Knibbs – HMRC's challenge to carry-back loss relief claims was correct

In *Knibbs and ors v HMRC* and *R (oao Astley and ors) v HMRC* [2019] EWCA Civ 1719, the Court of Appeal has held that Schedule 1B, Taxes Management Act 1970 (TMA), can apply to a claim for carry-back loss relief.

Background

The claimants had made claims to carry back losses arising from tax avoidance arrangements which they had participated in, either directly or through partnerships, mainly involving investments in films. It had been held (in other proceedings) that those arrangements failed to generate losses.

The central issue was whether the only way in which HMRC could enquire into the carry-back claims to "Year 1" was by means of a notice of enquiry given under paragraph 5(1)(a), Schedule 1A, TMA, or was it also open to HMRC to enquire into the claims under section 9A, TMA, as part of an actual or deemed enquiry into the taxpayers' self-assessment returns for "Year 2" (ie the year of assessment in which the claimed losses arose). As no enquiries had been opened by HMRC under Schedule 1A before the time limit expired, it was necessary to determine whether the carry-back claims fell within the exclusive ambit of Schedule 1A.

Following *R (on the application of De Silva) v HMRC* [2017] UKSC 74, HMRC's position was that it was entitled to enquire into the carry-back claims either under section 9A (into the claimants' self-assessment tax returns for Year 2), or under section 12AC, TMA (into the partnership returns). The claimants accepted that following *De Silva* the appeals of those claimants whose Year 2 was 2006/07 or earlier, being before the Income Tax Act 2007 (ITA) came into effect, would fail.

The claimants applied for declarations from the High Court (under CPR, Part 7) that their claims had become final and HMRC was obliged to give effect to them, as no HMRC enquiries had been made within the relatively short time limits for enquiries under Schedule 1A, TMA.

The High Court struck out the claims on the basis that (a) bringing the claims in the High Court was an "abuse of process"; and (b) that where a carry-back loss relief claim has mistakenly been given effect to, HMRC may seek repayment through an adjustment to the taxpayer's tax return for the year in which the losses arose.

The claimants appealed to the Court of Appeal. There was also before the Court of Appeal an application for permission to appeal against a High Court order refusing permission to proceed with an application for judicial review. Both cases raised essentially the same substantive issues of law and the six applicants in the judicial review proceedings were claimants in the Part 7 proceedings.

Court of Appeal judgment

The Court of Appeal, upholding the decision of the High Court, rejected the applications for declarations, for the following reasons:

(1) the applications constituted an abuse of process, and
(2) HMRC was entitled to enquire into the claims under sections 9A and 12AC, TMA.

Abuse of process

The Court held that the correct procedure for the individual partners to challenge the amendments made to their returns was by way of judicial review rather than seeking declarations from the High Court. The Court gave four principle reasons for this:

- there were no private law rights involved in the instant claim
- the time limits (in CPR 54) were a strong factor in favour of judicial review being the correct procedure
- the challenges affected a large number of people and raised no issues of fact that might be unsuitable for determination in judicial review proceedings
- the requirement for permission to pursue a judicial review did not make it an unsuitable procedure in the circumstances of the case, any more than in the many other tax and non-tax cases to which it applies.

The High Court was therefore correct to conclude that, irrespective of the merits of the substantive issues arising, the Part 7 proceedings should be struck out as an abuse of process.

Enquiry into the claims
In the view of the Court, the highly prescriptive scheme for calculation of income tax liability in Part 2, Chapter 3, ITA, did not have to be construed so as to exclude from its ambit the operation of paragraph 2(6), Schedule 1B, TMA in circumstances where a carry-back claim for trade loss relief had been made. In the opinion of the Court, it was clear that Parliament intended paragraph 2(6) to continue to apply to such claims, and that effect should therefore be given to them in the context of the Chapter 3 calculations of tax liability.

The Court explained that first, the list of reliefs deductible at step 2 in section 24(1), ITA, included trade loss relief against general income under section 64, ITA. As section 64 was contained in Part 4, Chapter 2, ITA, the relief was expressly made subject to paragraph 2, Schedule 1B, TMA (by virtue of section 60(2), ITA). Section 60(2) provided the necessary link between trade loss relief under ITA and Schedule 1B and showed that Parliament must have intended paragraph 2 to have full force and effect for the purposes of Part 4, Chapter 2, loss relief where the claim required the relief, or part of it, to be given in Year 1. In other words, the provisions of paragraph 2 would apply for the purposes of any claim to trade loss relief under ITA which was not confined to a "sideways" claim for relief in Year 2 alone.

The Court went on to say that it would be wrong to construe sections 23 and 24, ITA, in "hermetic isolation" from the rest of the Act, when section 24 required you to look at section 64, which was expressly made subject to paragraph 2, Schedule 1B, where the claim to trade loss relief had a carry-back element. Accordingly, calculation of the taxpayer's income liability for Year 2 under section 23 had to, where appropriate, take account of, and give effect to, the provisions of paragraph 2, Schedule 1B.

The Court emphasised that the taxpayer had to give full information about the claim in their Year 2 return, because it might impact on the amount of tax for which they were liable in that year; and HMRC could then open an actual or deemed enquiry into the Year 2 return under section 9A. Once the necessary link to Schedule 1B had been identified within ITA, there was no basis for distinguishing post-2007 claims from pre-2007 claims.

Comment
The Court of Appeal has confirmed in this case that tax returns for years in which losses arose that were the subject of carry-back claims, can be the subject of actual or deemed enquires by HMRC under sections 9A or 12AC, TMA, even though the losses arose in tax years after 2006/07.

The Court also confirmed that tax returns for years in which losses arose that were the subject of carry-back claims can be the subject of actual or deemed enquiries by HMRC, under sections 9A or (in the case of partnership losses) 12AC, TMA (sections 9A and 12AC), and that those returns can be amended to recoup sums wrongly paid to the taxpayers, even though the losses arose in tax years after 2006/07.

The Court has also made it clear that seeking declarations, in relation to tax issues, from the High Court where either a statutory right of appeal exists and/or the taxpayer has a right to seek judicial review of HMRC's decision, may amount to an "abuse of process".

The judgment can be viewed here.

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Higgins – for the purposes of PPR relief "period of ownership" starts on completion

In *Desmond Higgins v HMRC* [2019] EWCA Civ 1869, the Court of Appeal has held that the date of acquisition of an off-plan property for the purposes of principal private residence relief (PPR) was the date of completion and not the date of exchange of contracts.

Background

Mr Higgins (the taxpayer) paid a deposit for an apartment in London off-plan in 2004 (the property). A formal contract of sale was entered into in October 2006 and a 10% deposit was paid. Due to the 2008 financial crisis, building was delayed and completion did not occur until 5 January 2010. The taxpayer owned no other residence between July 2007 and January 2010 and there was no other dwelling that he regarded as a main dwelling during that period.

The taxpayer sold the property in 2012, making a capital gain before relief of approximately £640,000 and claimed PPR on the full gain. HMRC refused the claim on the basis the taxpayer's period of ownership began on exchange of contracts in October 2006.

The taxpayer appealed HMRC's decision to refuse his claim.

The issue for determination was the meaning of the words "period of ownership" in section 223, Taxation of Chargeable Gains Act 1992 (TCGA). If the period of ownership did not begin until completion on 5 January 2010, then the property was the taxpayer's main residence "throughout the period of ownership" and no capital gains tax would be payable due to PPR. If, on the other hand, the taxpayer's "period of ownership" began when contracts for purchase were exchanged in October 2006, he would only enjoy PPR on some of the gain made.

The First-tier Tribunal (FTT) allowed the taxpayer's appeal and held that the date of ownership began on the date of completion. HMRC appealed the FTT's decision to the Upper Tribunal (UT). The UT allowed HMRC's appeal and held that the date of ownership began on the date contracts were exchanged.

The taxpayer appealed to the Court of Appeal.

Court of Appeal judgment

The appeal was allowed.

The Court of Appeal considered that HMRC's case ran counter to the ordinary phrase "period of ownership", where a purchaser would be described as the "owner" once the purchase had been completed. The Court noted that if HMRC was correct, few people buying a home would come within the scope of section 223, TCGA, and benefit from PPR, because exchange and completion did not normally take place on the same day. In the view of the Court, the fact that someone has contracted to buy a property does not give them "ownership" so as to allow them to possess, occupy or even use the property, let alone make it their only or main residence.

Accordingly, the Court held that, for the purposes of section 223, the taxpayer's "period of ownership" did not begin until the date of completion of the purchase of the property.

Comment

This decision will be of interest to those involved in off-plan property purchases or other purchases where substantial delays may occur between the time of exchange of contracts and the purchaser residing in the property.

It is anticipated that HMRC will seek to appeal this decision to the Supreme Court.

The judgment can be viewed here.

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- Shortlisted – Insurance Team of the Year – Legal Business Awards 2018
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