Making tax digital

It's time for an open, extensive dialogue.

I have written in *Tax Journal* a number of times about making tax digital (MTD). My view all along has been that digital technology holds great potential for improving tax administration and compliance, but that it must be introduced in a way that avoids creating yet another administrative burden for small and micro businesses. That view has been widely shared.

One of the first decisions the new financial secretary to the Treasury, Mel Stride, took was to narrow the scope of MTD to VAT reporting for VAT registered business with sales below the VAT threshold, with no further rollout until April 2020 at the earliest. That very welcome decision recognises genuine concerns and creates time for the market to drive take-up of digital record keeping and for an extended pilot programme.

The MTD clauses inevitably featured in the second reading of the Finance Bill on 12 September. The minister reiterated that the government will not mandate MTD for other taxes until it is clear that the programme has been shown to work well and added that there would be an opportunity for businesses to use the system voluntarily as the pilot progresses. I hope that businesses and agents will take full advantage of that opportunity, as it represents a real chance to influence the shape MTD takes and to help ensure that it delivers for businesses as well as HMRC.

As the minister was making his comments on 12 September, HMRC was holding its annual stakeholder event at HM Treasury. At that event, HMRC's chairman Edward Troup said that a conversation was needed to take MTD forward. I asked how we could best start and then maintain that conversation. Jon Thompson felt that it was important for HMRC to go out to talk to businesses in order to try to understand their perspective. He is absolutely right. Every time we have been able to facilitate such contact, agents, businesses and HMRC have gained from the process.

At my firm we have invited HMRC to join – as 'observers' – our regular in-house sessions on MTD and digital developments. They hear at first hand our discussions on software and apps; on what we like and what we don't; on what works and what doesn't; on client reactions and on marketing, pricing, client support, training and recruitment. The more we can help HMRC understand the practical and technical issues involved, the more chance there is of MTD going with the grain of business needs. That is just one example of how a conversation can develop. Similar conversations are taking place between the ICAEW Tax and IT faculties and HMRC.

We are at a tipping point in the use of digital technology, where software and apps and the platforms they run on hold potential advantages for even some of the smallest businesses. MTD may be one catalyst for change, but it is not the only one: the market will (and should) be the most powerful driver. Increasing numbers of businesses will use digital tools to get the information they need and the tax information HMRC needs will emerge as a by-product. A natural momentum will build.

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The minister has said clearly that further mandation is off the table until the programme has been shown to work. That is precisely what many of us asked for, while emphasising we were in favour of better use of digital technology. It is now time to focus on realising the potential the technology holds and for an extensive, open dialogue between businesses, agents, professional and representative bodies, software developers and HMRC. A conversation in fact. ■

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Vigne and IHT business property relief

A recent tribunal decision provides helpful insight on the 'wholly or mainly of making or holding investments' test.

Most readers will be familiar with business property relief (BPR) under IHTA 1984 s 105 which can represent an effective exemption from inheritance tax. There are terms and conditions of course; one of these is that the relief will not apply if the business 'consists wholly or mainly of one or more of the following, that is to say, dealing in securities, stocks or shares, land or buildings or making or holding investments'.

Things are not looking good when it comes to the business of letting property. The tribunals have consistently held that letting property is an investment business, no matter how extensive the services which are provided. Obtaining business property relief for such a business is now a seriously uphill struggle.

The recent case of the *Executors of M Ross v HMRC* [2017] UKFTT 507 seems almost to conclude the issue. Mrs Ross was a partner in a partnership which operated some holiday cottages; the cottages were let and loads of services were provided to the guests. The tribunal acknowledged that a high level of services was provided to guests and these services were more extensive than those considered in any previous case. That sounded encouraging. However, it was irrelevant because, in the view of the tribunal, the relief would not be available 'however high the standard of services which were provided and whatever the level of expenditure incurred on those services'. The tribunal denied relief on the grounds that the business of the partnership consisted mainly of investment in property. The fact that the business was run on sound business lines and with much effort, was not relevant. I thought it would be significant that the tribunal (and HMRC) accepted that the business was operated in partnership. The mere ownership of properties jointly is not a partnership under the Partnership Act 1890, so they must have been carrying on a genuine business – but that did not make any difference either.

Interestingly, within a few weeks there was another case on the same point concerning a livery business, which provides a bit of encouraging light at the end of this tunnel: *Executors of M Vigne v HMRC* [2017] UKFTT 632. Naturally, land and buildings are an important part of any livery business and as discussed above, where land is involved, HMRC is reluctant to allow the relief. The tribunals take the view that the letting of property is a business which consists wholly or mainly in the making or holding of investments, no matter how extensive the services provided.

In the case of the livery business in this case, HMRC said that the business was nothing more than the letting or licensing of land for the use of others and therefore was an investment business – being the making or holding of investments.

> The FTT in *Vigne* said that this was the wrong test

However, the FTT rejected all the arguments of HMRC saying that no properly informed observer could have concluded that the business was that of holding investments. The FTT described the view of HMRC as a wholly artificial analysis. It is difficult to resist the observation that HMRC chose to advance a wholly artificial analysis in an attempt to win their case; something which they regard as absolutely unacceptable and deserving of seriously

penal sanctions – if done by anybody else.

Inevitably, cases on business property relief are heavily dependent on their facts, but one important issue emerged in this case which may be of wide application.

Where land is involved, HMRC is pretty keen on the following passage from the Upper Tribunal decision in *HMRC v Pawson* [2013] UKUT 50: 'The critical question, however, is whether these services were of such a nature and extent that they prevented the business from being mainly one of holding Fairhaven as an investment.'

The FTT in *Vigne* said that this was the wrong test. It started from the pre-conceived idea that the business is wholly or mainly one of making or holding investments and then to ask whether there are factors indicating to the contrary. The FTT explained that the proper starting point is to make no assumption one way or the other but to establish the facts and determine whether the business is wholly or mainly one of making or holding investments. ■

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BT Pension Scheme

A recent CJEU judgment provides guidance on the rights of shareholders affected by the UK's FID regime.

The UK's foreign income dividend (FID) regime was held to be in breach of TFEU article 63 in *Test Claimants in the FII Group Litigation* (C-446/04) ('*FII ECJ 1*'). The CJEU's recent judgment in relation to proceedings between the trustees of a pension scheme and HMRC (*The Trustees of the BT Pension Scheme v HMRC* (Case C-628/15), reported in last week's edition) further clarifies the implications of the FID regime being contrary to EU law, and in particular the rights of shareholders affected by the FID regime. The CJEU followed the advocate general in its answers to the questions referred.

The CJEU concluded that shareholders who had received FIDs had rights pursuant to article 63, and were entitled to a remedy for breach of that article. Under the FID regime, shareholders did not receive a tax credit in respect of ACT paid by the parent company on distribution of a FID when such a tax credit was available in respect of dividends paid out of income from a UK source. This put those shareholders in a worse position if they received FIDs than if they received dividends paid from income with a UK source, as they would receive a tax credit entitling them to a payment from HMRC in relation to the latter but not the former even though FIDs had to carry credit for foreign tax up to the UK rate.

Further, the CJEU considered that it was irrelevant that the trustees were not subject to income tax in respect of dividends received by them and that the referring court did not consider that the infringement of EU law was sufficiently serious to give rise to non-contractual liability by the member state in favour of the companies distributing the dividends.

The CJEU also concluded that the fact that a company distributing dividends may have increased the amount of its dividends to make up for the lack of a tax credit would not lead to double recovery if shareholders could claim the tax credit from HMRC. This was for two reasons. First, *FII ECJ 1* had previously concluded that companies increasing their dividends for that reason could not bring a claim for the increased amount because the increase was the result of their own decision making. However, the fact that shareholders were not entitled to a tax credit in respect of FIDs was not the result of their own decision, but the relevant legislation. Second, an increase in the amount of dividends could not be equated with the grant of a tax credit. The rights and obligations of HMRC were therefore unaffected by the amount of dividends the parent company chose to distribute to its shareholders. ■

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