Croner-i Tax Weekly

MONTHLY ROUNDUP

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Editor-in-chief: Glyn Fullelove

Articles Contributed by:

Glyn Fullelove

Neil Warren

Meg Wilson

Heather Townsend

Paul Davies

Tim Palmer

Welcome to this monthly round-up edition of Croner-i's Tax Weekly e-magazine on all of the latest tax news.

We have included a wide range of opinions on this controversial topic none of which necessarily reflect the views of Croner-i.

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Croner-i
Tax Weekly

Contents

1. VAT: What a difference a day makes
   Neil Warren clarifies the dates when late payment penalties will be issued by HMRC when the new penalty regime takes effect on 1 January 2023

2. Tax and Metal Health
   Ahead of World Mental Health Day on 10 October, Meg Wilson considers measures in the tax system to help taxpayers with mental health problems.

3. If your employees are ‘Quit Quitting’, here’s what it means
   The phrase ‘Quiet Quitting’ is all over social media and the internet right now. Heather Townsend looks at what it really means, and what you can do to stop your employees from doing it.

4. Euromoney case: Tax avoidance motive does not prevent share exchange relief
   Paul Davies looks at the recent case of R & C Commrs v Euromoney Institutional Investor Plc [2022] BTC 521, which considered whether the main purpose of arrangements involving an exchange of shares was the avoidance of tax.

5. Personal fitness training for the self-employed
   Tim Palmer looks at when self-employed taxpayers can successfully claim tax relief for personal fitness training expenditure.

6. The right reward for R&D?
   Glyn Fullelove, Editor-in-chief, suggests there is one question above all others that needs to be addressed with the UK’s R&D tax relief regime – is it a reasonable reward for R&D expenditure?

Croner-i
Tax Weekly

VAT: What a difference a day makes

Neil Warren CTA (Fellow), ATT

Dates are very important in the world of tax – and in life generally. For example, a recent announcement following the passing of the Queen was that all football matches would be cancelled 'until Tuesday'. This confused me: did that mean that Tuesday games were also cancelled and football started on Wednesday, or that Tuesday matches were OK? A couple of friends and I debated the meaning of the word 'until' but we couldn't agree.

By my own admission, I also got confused about the dates when penalties will be triggered for paying VAT late with the new penalty regime that will take effect for periods beginning on or after 1 January 2023. I read a word in HMRC's guidance which I wrongly interpreted but fortunately the legislation was much clearer. Read on and all will be revealed.

Basic rules of new system

I am as excited by the new penalty regime as a teenager buying an overpriced pair of designer training shoes, because it will be a massive improvement on the existing default surcharge system. This is because a business currently gets the same penalty for paying its VAT return one day late as one year. That cannot be fair.

With the new system, there will be no penalty if tax is paid – including part payments – by day 15 after the due payment date. In the first year of the new regime, there will be no penalty if tax owed on a return is fully paid within 30 days of the due date. Note the word 'fully' in this sentence. But let's clarify the phrase 'day 15' with an example.

Example

VAT period ends on 31 March 2023

Due date for submitting return online and paying tax – 7 May 2023

Day 15 after the due payment date is 22 May 2023. A penalty will be triggered for VAT unpaid at the end of this day. In other words, a 2% penalty will be issued for tax unpaid at the start of day 16.

Date confusion

The relevant legislation about the new system is contained in FA 2021, s. 117 and Sch. 26, and HMRC's published guidance can be found at https://tinyurl.com/yckz4x2k.

So, to get back to the key theme of this article (pause for dramatic effect): what was the reason for my confusion about the 15 day deadline?

The answer is that HMRC's guidance states that a 2% penalty would apply to tax 'you owe at day 15 plus 2% on the VAT you owe at day 30'. In other words, the penalty rate of 2% at day 15 becomes 4% at day 30. So, we get to the start of day 15 and VAT on a return is outstanding – in my mind, the word 'at' means that a penalty would now be due. However, Sch. 26, Pt. 2 confirms that no penalty will be due on tax paid 'before the end of the 15 day period'.

A 2% penalty will apply to tax unpaid 'after the end of the 15 day period but before the end of the 30 day period' (author emphasis). The word 'period' is confirmed as starting from the day after the due payment date. To quote the old song … what a difference a day makes. The use of the word 'end' in the legislation is – in my view – much clearer than the word 'at' in HMRC's guidance.

30-day penalty

The same principle applies to the second penalty that will be charged for tax unpaid more than 30 days after the due date. In other words, the penalty will be issued on day 31.

Example

VAT period ends on 31 March 2023

Due date for submitting return and paying tax – 7 May 2023

Day 30 after the due payment date is 6 June. An extra 2% penalty will be triggered for VAT unpaid at the end of this day. In other words, the penalty will be issued for tax unpaid at the start of day 31.

Note – for tax still unpaid after the end of day 30, an annualised penalty rate of 4% will be applied thereafter. And for all tax unpaid by the due payment date (7 May in my examples), interest will be charged. The rate will be 2.5% above the Bank of England's base rate. Don't forget that interest is not a penalty, it is commercial restitution to compensate HMRC for late payments.

Is it 'and' or 'or'?

Another important point of detail to consider when reading HMRC guidance or the legislation on any VAT subject is whether the word 'and' or 'or' is relevant to a particular situation. For example, the legislation gives HMRC the power to treat two separate businesses as a single entity if they are closely connected by economic links, financial links and organisational links. The key word here is 'and' – in other words, HMRC need to prove that all three links are evident before they can issue a direction. One or two out of three is not good enough.

Another example of 'and' is the list of conditions that need to be met for a business sale to potentially qualify as a TOGC with no VAT charged on the assets being sold. In contrast, the legislation on VAT registration requires a business to register if its taxable sales have exceeded £85,000 in any rolling 12-month period or if it expects its sales to exceed that figure in the next 30 days alone.

Finally, to put you out of your suspense, the Tuesday football matches were played – perhaps not such a good thing because the local team I follow in Birmingham yet again failed to win: Walsall 1 Colchester 1.

For further commentary on the new penalties regime, see In-Depth at 197-690.

Tax and mental health

Meg Wilson, Lead Technical Writer at Croner-i Ltd on direct tax

Introduction

One in four of us will experience a mental health problem. It is therefore vital that the tax system is suitably equipped to assist those affected and not to unnecessarily penalise non-compliance caused by mental health issues. This article looks at measures in place to help taxpayers, and what we can learn from cases citing mental health problems.

Tax legislation

Some tax legislation specifically refers to a taxpayer's mental health. For example:

- the information and inspection powers of HMRC (FA 2008, Sch. 36), Revenue Scotland (Revenue Scotland and Tax Powers Act 2014, Pt. 7) and the Welsh Revenue Authority (Tax Collection and Management (Wales) Act 2016, Pt. 4) are all subject to restrictions preventing a taxpayer from being compelled to provide information relating to their mental health; and
- before HMRC can use their powers to recover debts directly from a taxpayer's bank account they are required to consider whether the taxpayer is disadvantaged in dealing with their tax affairs, which per HMRC's policy paper includes considering mental health conditions (F(No. 2)A 2015, s. 51 and Sch. 8).

The HMRC Charter

HMRC's Charter provides that HMRC will aspire to listen to a taxpayer's worries and answer any questions clearly and concisely, and will be mindful of a taxpayer's wider personal situation, and will give them extra support if needed.

The extra support, in the form of a phone or video appointment with HMRC's extra support team, is however limited to questions about Child Benefit, PAYE and self-assessment.

Reasonable excuse cases

Given the high number of people with mental health problems it is no surprise that many appeals against non-compliance penalties refer to a taxpayer's mental health as providing them with a reasonable excuse for their failure.

Both HMRC and the tribunals agree that mental health issues can be a reasonable excuse. However, as Judge Brannan recently said in the First-tier Tribunal (FTT) case of Breen [2022] TC 08482 (which the taxpayer lost):

'Without wishing to be prescriptive, there would in most cases need to be evidence that the mental health issue in question was such that the taxpayer cannot deal with his or her affairs to such an extent that the taxpayer cannot submit a return or perform the necessary preparation to submit a return.'

The lack of evidence is the usual reason why such appeals fail. For other examples see Atkins [2018] TC 06439 and Baker [2019] TC 06896.

The tribunals are sometimes more sympathetic than HMRC when considering the issue of mental health problems, especially when they are ongoing. For example, in AZ v R & C Commrs [2011] BTC 1,777, the Upper Tribunal (UT) found that based on evidence from a psychiatrist the taxpayer had a reasonable excuse for non-compliance and this continued for longer than the FTT had allowed.

The FTT case of Hindocha [2017] TC 05838, concerned penalties for the late filing of a tax return and the late payment of tax. HMRC argued that because the taxpayer's anxiety and depression were ongoing he should have made arrangements for completing and sending his tax return on time. However, the FTT cancelled the penalties because it accepted that given the nature of the taxpayer's illness he was unable to make such arrangements.

A similar decision was reached in Appellant [2017] TC 05564, where the FTT found that the appellant's schizophrenia provided her with a reasonable excuse for failing to deal properly with her tax affairs for many years. Judge Mosedale highlighted that while she found that the appellant's mental health amounted to a continuing reasonable excuse for her failure to deal properly with her tax affairs, it had no relevance to her liability to file returns and pay tax, which applied to everyone, which Judge Mosedale noted was 'a highly unsatisfactory position for both HMRC and the taxpayer'.

In the recent case of Harrison v R & C Commrs [2022] BTC 525, the UT agreed with the FTT (and HMRC) that a taxpayer who had suffered many distressing personal and business events and who had been suffering from depression, did not have a reasonable excuse for his failure to file his return. While it was accepted that he might have had a reasonable excuse at the time of the filing deadline, it was decided that the excuse had ended and he had not submitted the return quickly enough after the excuse ended.

Deliberate actions

In my opinion worryingly, in the Harrison case the UT upheld a decision of the FTT that by a taxpayer with depression not signing and returning his return he had deliberately withheld information and was therefore subject to a tax-geared late filing penalty of over £42,000.

The UT rejected the challenge to the finding of fact, that the taxpayer had taken the initiative to ask his accountants to prepare his return, from which the FTT concluded that he 'had the capability to take the steps required to fulfil his responsibilities' and therefore he had deliberately intended not to file his tax return. Although the taxpayer's evidence was that it was his accountant who had taken the initiative, the UT decided that the FTT was entitled to make this challenged finding of fact.

HMRC's duties under the Equality Act 2010

Where a person's mental health problem is a disability, the Equality Act 2010 gives the person protection from discrimination. Under the Act, where HMRC propose to carry out an act which may affect a person who is known to have a disability, they have a public sector equality duty to carry out an 'open-minded conscientious enquiry' of the potential impact of that act on that person before so acting; and a 'duty to make adjustments'.

The duty to make adjustments comprises these three requirements:

- where a provision, criterion or practice of the person on whom the duty is imposed puts a disabled person at a substantial disadvantage in relation to a relevant matter in comparison with persons who are not disabled, to take such steps as it is reasonable to have to take to avoid the disadvantage;
- where a physical feature puts a disabled person at a substantial disadvantage in relation to a relevant matter in comparison with persons who are not disabled, to take such steps as it is reasonable to have to take to avoid the disadvantage; and
- where a disabled person would, but for the provision of an auxiliary aid, be put at a substantial disadvantage in relation to a relevant matter in comparison with persons who are not disabled, to take such steps as it is reasonable to have to take to provide the auxiliary aid.

The High Court bankruptcy petition of R & C Commrs v De Freitas [2022] BTC 26, considered whether HMRC had met their duties under the Equality Act 2010. It was common ground that, by reason of mental health issues, the debtor had a disability within the meaning of the Equality Act 2010, s. 6(1). The Court decided that HMRC had not breached the Equality Act 2010. HMRC had considered the impact that bankruptcy proceedings would have on the debtor's mental health before serving the petition. It was not clear that a delay by HMRC in pursuing bankruptcy proceedings would have served any useful purpose, such that HMRC's decision to proceed with the petition amounted to a breach of the 'duty to make adjustments'. HMRC's Debt Management and Banking Manual (DMBM585185) provides guidance for those considering enforcement in respect of taxpayers with mental health issues.

Private hearings and anonymised decisions

In the interests of open and public justice, it is the general rule that tribunal hearings are heard in public and full decisions are published without protecting anyone's identity. However, appeals can be heard in private and decisions can be anonymised. Given the understandable desire for many taxpayers to keep any mental health issues out of the public domain, together with the importance of publishing decisions to help us understand how tribunals apply the law, anonymising such decisions would seem a good approach. This is what happened in Appellant [2017] TC 05564. Not doing so routinely risks discouraging others with mental health problems from appealing HMRC decisions.

Conclusion

It is all too easy to advise people with mental health problems to talk about their problems and to get help. In reality, for someone suffering, to reach out and find appropriate help is much more difficult. I suspect there is more that both HMRC and agents can do to identify those with mental health problems and to help them deal with their tax affairs. For those taking cases to tribunal and citing mental health as a reason for a taxpayer's non-compliance, it is key to ensure evidence is provided as to why the taxpayer's mental health problems prevent them from meeting their compliance obligations.

Useful links

For commentary on when a person's mental health can provide them with a reasonable excuse, see In-Depth at 197-315 and for HMRC's guidance see CH160400.

Since this article was first published HMRC have announced that they are working with Samaritans to deliver an 18-month project to improve the emotional support available for taxpayers.
(Per https://www.gov.uk/guidance/voluntary-and-community-sector-organisations-who-can-give-you-extra-support.)

If your employees are 'Quiet Quitting', here's what it means

Heather Townsend, founder of The Accountants' Growth Club and author of How To Make Partner And Still Have A Life

What is meant by Quiet Quitting?

There is no one definition of what it means to Quiet Quit. It does not mean leaving your job. It can mean some or all of the following:

- not going the extra mile at work;
- only working the hours they are being paid for;
- setting boundaries and not taking on additional work/responsibilities;
- not subscribing to the hustle mentality to progress their career.

Given that many tax practices rely on employees to work significantly more than they are paid to do in Busy Season, this is a worrying trend. Indeed, firms have often correlated people with partner potential to those that are prepared to hustle in the early days of their career.

There is an argument that says Quiet Quitting is about reminding employees to not work to the point of burnout. It's not necessarily about just doing the minimum amount of work required. It's about being productive in the hours you are at work and not making work your 'be all and end all'.

This is what is worrying about Quiet Quitting

There is a school of thought that Quiet Quitting is a reaction to Covid-19 and the Great Resignation. After a number of years of uncertainty, Quiet Quitting is a way for employees to take back control of their work and personal life. If, for whatever reason, an employee doesn't believe they have the luxury of resigning, Quiet Quitting is the next best option.

Read any of the articles about Quiet Quitting and the 'Quiet Quitters' appear to be younger employees who then resign from their current roles: over the next 12–18 months they either change jobs or set up on their own. It appears, despite the many definitions of Quiet Quitting, that it is often the first step in disengaging from a role. This matches up with what Gallup found in a recent survey: 54% of employees born after 1989 are not engaged employees. This category of 'not engaged' employees highly correlates with Quiet Quitting.

Tax practices have always had to contend with employees, albeit a minority, who have been able to put the minimum effort in. That's nothing new. With many more employees working remotely, it becomes much easier to float underneath the radar of senior management. It also becomes much easier to Quiet Quit without anyone in senior management realising it.

Quiet quitting can also cause conflict between employees in the workplace. After all, if not everyone on a team is pulling their weight it can quickly lead to resentment. This can prompt a situation where your top performers get disgruntled with the state of affairs and start looking for a new role in a different firm.

What can your firm do about Quiet Quitting?

If Quiet Quitting is all to do with employee engagement, then the first place to start is look at the leadership and culture of your firm.

Don't make employees have to work full-time from the office

The older members of your firm probably are used to working long hours from an office. In fact, they may suggest the answer to the current issues with employee engagement and morale is to 'get people back into the office'. Whilst this is tempting, it is likely to lead to a mass exodus of employees. Our sister company, The Accountants' Recruiter, has found that the candidates they are placing are predominantly looking for flexibility where they work. They want to have their cake and eat it – i.e. they want to be able to come into an office but also have the flexibility to work at home a number of days per week. Indeed, this is backed up by numerous studies in the workplace. Deloitte found in 2020 that nearly 50% of all professionals value remote work and flexible work hours the most. In 2022, Deloitte Australia did some research which found that:

- 93% of workers surveyed say their physical, emotional and mental wellbeing is just as important as pay;
- 78% of workers who can work remotely want to work hybrid or from home.

Prioritise partners' and senior fee earners' self-care

Most of your senior fee earners and partners are used to putting in a full shift at the office. They may have always worked as long as was needed to get the work done, even if this was at the expense of their personal life and own well-being. If you look around your partners, how many of them have chalked up a divorce or two? Or look like they have sacrificed their liver and waistline for the cause? Is it any wonder that many of your younger employees are looking up and not aspiring to be the next partner in your firm?

The example that partners and senior fee earners set with their working hours and boundaries often dictates the culture in a team or office in a firm. Whereas if younger employees can see that senior leaders prioritise self-care, for example being properly off when on annual leave, or rarely working weekends, this will trickle down for the rest of the firm. If younger employees can see that senior management values downtime, they are less likely to need to Quiet Quit.

Respect employees' time off

Part of this Quiet Quitting movement is about setting firm boundaries and not working long hours or working at weekends or on holidays. Therefore, if firms are to avoid Quiet Quitting, they need to minimise the requests for younger employees to 'pull an all-nighter at work' or give up part of their weekends to work. This means using scheduling tools so that employees don't get e-mails that require a response at the weekend or in the evenings. It also means looking at the expectations that are routinely set for employees. Employees, whilst they need to earn their keep, are not assets to be sweated. Any firm which is routinely requiring employees to bill more than six hours a day needs to take a long hard look at its business model.

More communication and direction

Whilst hybrid working can have great benefits including increased productivity, it very quickly exposes poor management and leadership in a firm. This poor management and leadership can very quickly lead to employees feeling undervalued and that their role lacks purpose. Gallup found that many younger employees do not feel that their work has purpose. After all, this is the generation that has found that for two to three years of their formative career they have been working from home for large chunks of time. If you then add in the fact that many tax practices have a matrix structure where there are weak relationships between counselling managers and their direct reports, is it any wonder that many of our younger employees are considering Quiet Quitting?

When working in a hybrid fashion, employees need more structured and purposeful communication. After all, management by walking about just doesn't work when people are not always in the office.

This means looking at how and when you as a firm are communicating with employees. From the top-down communication through to how assignment/project leaders and counselling managers are communicating with their team members and direct reports. After all, it's very difficult to Quiet Quit when you believe that someone cares about you and is regularly checking in with you to see how you are getting on with your work.

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Euromoney case: Tax avoidance motive does not prevent share exchange relief

Paul Davies, Senior Tax Writer, Croner-i Ltd

Euromoney Institutional Investor plc (Euromoney) was a subsidiary of Daily Mail and General Trust plc (DMGT). Alongside its joint venture partner, Dealogic Ltd, Euromoney held shares in two joint venture companies. Euromoney's holding in one of the joint venture companies, Capital Net Ltd (CNL), qualified for the substantial shareholdings exemption (SSE) however its holding in the other joint venture company, Capital Data Ltd (CDL), did not (no entitlement to dividends).

In September 2014, an unconnected private equity group (Carlyle) agreed to acquire Dealogic Ltd's parent company, Dealogic Holdings plc (DHPLC), and also offered to buy Euromoney's interests in CDL and CNL. It was subsequently agreed that Euromoney would sell its stake in CDL for a total of $80.44m. $21m would be settled in cash with the balance settled in ordinary shares in DTL, the Dealogic acquisition vehicle.

The terms of the deal were later renegotiated at the request of DMGT such that, in place of the cash element, Euromoney would instead receive preference shares, redeemable after more than one year. The stated intention was 'to avoid paying tax on the capital gain for the cash element of the transaction' because, after one year, the conditions for SSE on the preference shares would be satisfied by virtue of the equity stake.

On 5 November 2014 a binding agreement was reached and the deal completed on 18 December 2014. Euromoney applied for clearance under TCGA 1992, s. 138 on 5 November which was refused on 19 December 2014 on the basis that Euromoney's exchange of its shares in CDL was part of a scheme or arrangement, a main purpose of which was the avoidance of liability to corporation tax. Consequently, it was HMRC's contention that the 'no disposal' rule in TCGA 1992, s. 135 could not apply and that a chargeable gain of c. £10m arose on the disposal of Euromoney's entire shareholding in CDL, not just the proportion represented by the preference share consideration.

There were two principal areas of discussion at the First-tier Tribunal (FTT):

1. Was the exchange part of a scheme or arrangements and, if so, what were they?
2. Was there a purpose of avoiding a tax liability and, if so, was it a main purpose?

In relation to the first point, HMRC's argument that the arrangements in question should be restricted to just the replacement of the cash consideration with the preference share consideration was rejected by the FTT. The correct interpretation of TCGA 1992, s. 137(1) required consideration of the entire share exchange, not just the preference share element, and the House of Lords decision in IR Commrs v Brebner (1967) 43 TC 705 supported the view that the scheme or arrangement must be considered as a whole.

The FTT went on to conclude that avoiding liability to tax was a purpose of the arrangements because changing the form of the consideration had no other commercial purpose. Tax avoidance was not however a main purpose of the arrangements because the evidence of Euromoney's witnesses that their main subjective purposes were commercial and that tax considerations were not important.

The FTT also considered HMRC's submissions that witness evidence alone should not determine the outcome of the case and that 'all the other evidence … must be taken into account as well', noting that in Travel Document Service v R & C Commrs [2018] BTC 13 the Court of Appeal upheld a finding that loan relationships of a company had a main purpose of tax avoidance notwithstanding the

unchallenged witness evidence that the company's purpose was entirely commercial. In this regard the FTT concluded that:

1. the size of the tax advantage that Euromoney sought was £2.8 million and that while this was a significant sum of money in absolute terms, in relative terms it represented less than 5% of the total sale consideration and so was not 'of such significance in the context that gaining it must have become a main purpose';
2. the 'natural inference' it drew from the fact that Euromoney did not explore the tax implications and was not aware of the 'downside' risk of the arrangements was that it did not consider the tax advantage to be significant in the context of the arrangements as a whole; and
3. that the overall investment of time, effort and expense by Euromoney in the preference share arrangements was not significant in the context of the arrangements as a whole.

Whilst this was enough to determine the appeal in Euromoney's favour, the FTT also considered Euromoney's argument that there was no 'avoidance' in any event because, by arranging matters so that it could benefit from SSE on redemption of the preference shares, Euromoney was simply accepting 'an offer of freedom from tax which Parliament had deliberately made'. This latter argument was rejected on the basis that a straightforward sale of Euromoney's shares would not have benefited from SSE, therefore Euromoney was doing something more than availing itself of an exemption that was straightforwardly available.

HMRC appealed to the Upper Tribunal on the grounds that:

1. The FTT erred in law by applying the wrong test in determining whether the exchange was part of a scheme or arrangements, and what the scheme or arrangements were, within the meaning of TCGA 1992, s. 137(1).
2. Even if the FTT followed the correct approach to ascertaining the scope of the arrangements, the FTT's conclusion that those arrangements did not have a 'main purpose' of avoiding a liability to corporation tax was 'vitiated by errors of law of the kind set out in Edwards v Bairstow [1956] 36 TC 207'.

In relation to the first point, the Upper Tribunal drew the following conclusions on the second limb of TCGA 1992, s. 137(1) derived from the limited assistance provided by Snell v HMRC [2007] BTC 62 and the ordinary meaning of the statutory words used:

1. The first question to be addressed is whether the exchange 'forms part of' a 'scheme or arrangements' and, if so, what the scheme or arrangements consist of. These questions involve ordinary words of the English language and it is a question of fact for the FTT to determine how they should be answered in any particular case.
2. If an exchange forms part of a scheme or arrangements, there is then a second question of fact for the FTT to determine, namely whether the main purpose, or one of the main purposes of that scheme or those arrangements is avoidance of liability to capital gains tax or corporation tax. That requires an examination of the purpose or purposes of the totality of the scheme or arrangements. Identification of the purpose or purposes of individual steps or constituents of the scheme or arrangements is not irrelevant as it may help to ascertain the purposes of the scheme or arrangements as a whole. However, it is the purpose or purposes of the overall scheme or arrangements that matter.

The FTT was not therefore compelled to focus on any particular aspect of the transaction, rather, it was for the FTT to decide, as a question of fact, on the scope of any scheme or arrangements in the particular circumstances of this case. Accordingly, the FTT was entitled to conclude that a consideration of Euromoney's subjective purposes was at the heart of the analysis since the initiative for the creation of the preference shares came from Euromoney.

In different cases, it may be that a wider examination of the subjective intentions of a wider number of counterparties would have been relevant. Since the FTT's conclusion was essentially factual, it could not be shown to be incorrect by considering consequences that might follow if that approach were followed in different situations. The appeal under ground (1) was dismissed.

The Upper Tribunal expressed no view as to whether ascertaining the 'purpose' of any scheme or arrangements involves a subjective test, an objective test, or a combination of the two. That issue was not argued, both parties being content to proceed on the basis that it was a purely subjective test.

With regard to HMRC's challenge under Ground (2), brought under Edwards v Bairstow principles, HMRC argued that, in its evaluation of purpose, the FTT took into account irrelevant considerations, failed to take into account relevant considerations, and reached irrational conclusions. In particular, while the tax advantage that the preference shares delivered was significant in absolute terms at £2.8 million, it represented less than 5% of the sale consideration and so was not significant in relative terms. That, argued HMRC, was an irrelevant consideration since the question is one of subjective purpose and Euromoney's own witnesses had not considered the tax saving relative to total consideration. The Upper Tribunal rejected this argument holding that HMRC itself had directed the FTT to look beyond just the subjective intentions of the parties following Travel Document Services. The FTT had made no error in law by taking account of other evidence that might shed light on those subjective intentions. The FTT was entitled to conclude that the relatively modest size of the tax advantage viewed in the context of the deal as a whole was relevant. Its conclusion, that this suggested that avoidance of tax was not a 'main purpose', was a conclusion that was open to it to make.

Similarly, it was a matter for the FTT to evaluate the significance or otherwise of Euromoney's ignorance of the downside. There was evidence before the FTT that Euromoney's analysis of the tax consequences of the insertion of the preference shares into the structure was limited. The flavour of the evidence was that the tax advantage was not very important. There was evidence that the tax advice received was quite cursory. It was open to the FTT to infer that the downside was not identified because Euromoney did not perform, or ask its advisers to perform, a detailed tax review. The FTT was entitled to conclude that this tended to suggest that Euromoney did not regard the tax advantage as particularly important in the context of the scheme.

Finally, the FTT was also entitled to consider that an analysis of the amount of time and expense Euromoney spent on different components of the overall scheme or arrangements had something to say about its beliefs as to the relative importance of those components. It was for the FTT to evaluate what conclusions should be drawn from that analysis.

The appeal under ground (2) was also dismissed.

This case demonstrates that a stated intention to avoid tax will not always rule out the application of the share exchange rules in TCGA 1992, s. 135 as long as the taxpayer can demonstrate, as a finding of fact, that the tax avoidance motive was not a main purpose of the arrangements in question. Once the FTT has determined the facts, it was always going to be an uphill struggle for HMRC to overturn them.

For further reading on this topic, see In-Depth at 561–800.

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Personal fitness training for the self-employed

Tim Palmer, CTA ATT

When can self-employed taxpayers successfully claim tax relief for personal fitness training expenditure? Tim Palmer reviews the position.

Can a self-employed individual claim tax relief for the fees that he pays to a personal fitness trainer who he engages once a week? In the majority of cases the answer will be no because the expenditure will not have been incurred wholly and exclusively for the purposes of the trade.

A self-employed accountant might be very conscious of the need to keep fit and alert in order to perform his heavy workload. Accordingly, he runs twice a week and every Saturday morning he books and engages a personal fitness trainer at his local gym.

The fees charged by the personal fitness trainer would not be an allowable trading deduction. He would not be entitled to make a claim under ITTOIA 2005, s. 34 in respect of the fitness training expenses. Under this section, no deduction is allowed for expenses that are not incurred wholly and exclusively for the purposes of the trade or profession. HMRC would correctly assert that there is an element of duality of purpose in the fitness training, and that the expenditure was not incurred wholly and exclusively for the purposes of his trade.

However, let us consider the position of a professional boxer. He has a big fight coming up in three months' time. Accordingly, he engages the services of a reputed personal fitness trainer to get him into top physical condition prior to the fight. The fitness training costs would be allowable as trading expenditure incurred wholly and exclusively for the purposes of his trade. Any personal benefits would be incidental. There would be no duality of purpose.

Likewise, a professional tennis player might engage a top fitness trainer to get her into shape prior to the start of the new year. For similar reasons to the boxer, the costs of such fitness training would be an allowable trading deduction.

Inevitably there are going to be various situations where the tax position relating to the personal fitness training is not clear cut.

In 2020, the First Tier tax Tribunal (FTT) heard the case of Osborne [2020] TC 07851. The taxpayer, Mr Osborne, was a deep sea diver and claimed the cost of his fitness training as a trading expense. Indeed, Mr Osborne was a saturation diver. Saturation diving allows professional divers to live and work at pressures greater than 50 msw for days or weeks at a time. This type of diving facilitates greater economy of work and enhanced safety for the divers.

The claim was made by his accountants, on his behalf, that the expenditure was incurred wholly and exclusively for the purposes of his trade. The claim comprised the cost of his gym membership, his fitness trainer's fees and his travelling expenses to and from the gym. HMRC did not allow the claim, stating that there was duality of purpose and that the expenditure was not incurred wholly and exclusively for the purposes of his trade. Mr Osborne appealed and the case went to the FTT.

The judge remarked that saturation diving was extremely dangerous and deep sea divers did indeed have to meet a very high level of personal fitness. Mr Osborne had consulted a diving doctor and also a personal fitness trainer to ascertain the most appropriate forms of personal training and exercise. The personal training expenditure was incurred both to enable him to keep fit enough to perform his work, but also to allow him to lengthen his career.

The judge considered in depth all Mr Osborne's arguments and reasoning. He found that Mr Osborne's only motive for the training was to maintain his level of lung, heart and muscular fitness so

that he could work as a deep sea diver. These were a matter of physical necessity. The tribunal judge concluded that the taxpayer would not train to this extent and level other than for the purpose of maintaining the high fitness level needed as a deep sea diver. The judge stated that it was not reasonable to infer that he undertook the training because of a subconscious motive to keep fit as a human being. ‘Any improvement to his fitness was incidental.’ The taxpayer won! The fitness training costs were allowable as trading expenditure wholly and exclusively for the purposes of his trade! There was no duality of purpose. The taxpayer’s appeal was successful and allowed.

I feel that this was the correct decision. Osborne’s sole motive for this fitness training was to maintain the level of lung, heart and muscular fitness needed to work safely as a saturation diver.

Inevitably, in practice, there will be more complex and debateable situations and claims. Take for example the position of a self-employed bodyguard. He is hired on a six month contract to look after and protect a very well known public figure. The work is dangerous and he will be required to be in both top physical and mental condition prior to the commencement of the contract. He therefore books regular personal fitness training sessions for the two months prior to the engagement. The trainer maps out a specific personal training programme for the bodyguard, including reaction routines and combat training. Would the training costs be an allowable trading deduction?

HMRC might seek to disallow tax relief for the fitness training costs on the grounds of duality of purpose. They would no doubt argue that the fitness training benefits the bodyguard on a personal basis and was therefore not incurred wholly and exclusively for the purposes of his trade. However, I think that they would be wrong to do so!

The only purpose of undertaking the fitness training was to enable him to work safely and effectively as a bodyguard in potentially extremely difficult and dangerous circumstances. This is a matter of physical necessity. His fitness training regime would be far removed from his personal physical requirements. Any improvement to his personal fitness would be incidental.

Conclusion

Personal fitness training for self-employed professional sportsmen and sportswomen will generally be an allowable trading deduction. Going further from there, successful tax claims under ITTOIA 2005, s. 34 for personal fitness training will depend on the nature of the extreme professional and trading activities in point.

Each particular case will depend on its own specific circumstances, facts and requirements. Such claims in practice need careful consideration in order to meet the conditions within s. 34 and to prove that there is no duality of purpose.

For commentary on the wholly and exclusively rule see In-Depth from 208–000.

Tim Palmer CTA ATT is the Senior Partner with Palmer Consultancy Partnership. He regularly lectures all over the UK, on all areas of tax, and also presents webinars on these subjects.

Away from his lecturing, he is a tax consultant with Arram Berlyn Gardner (ABG) Chartered Accountants London.

Croner-i Tax Weekly

The right reward for R&D?

Glyn Fullelove, Tax Weekly, Editor-in-chief

I recently completed re-vamps of both Croner-i's Quick Overview and In-Depth coverage of tax reliefs for R&D. This left me wondering what my overall sense of the current reliefs was, especially since the Treasury is still conducting a review into R&D tax reliefs. The Finance Bill Sub-Committee of the House of Lords Economic Affairs Committee is also looking at how the changes in the R&D rules in the forthcoming Finance Bill will affect claims for relief.

Undoubtedly, I would agree with Henderson J who in the case of Gripple v R & C Commrs [2010] BTC 873, commented that 'the provisions form a detailed and meticulously drafted code, with a series of defined terms and composite expressions, and a large number of carefully delineated conditions, all of which have to be satisfied if the relief is to be available'.

For expenditure to qualify as R&D it must first meet an accounting test – it has to be expenditure that would qualify as R&D under generally accepted accounting principles. However, accounting standards are less interested in defining a category of identifiable R&D expenditure than specifying that research should be written off whilst development may sometimes be capitalised. It is thus not surprising that this accounting requirement is then supplemented by the need for R&D expenditure to meet the Department for Business, Energy and Industrial Strategy guidelines. In addition, the legislation then specifies at some length which categories of expenditure falling under the accounting definition and guidelines actually qualify for relief.

By this point, we are deeply into a 'rules based' regime. A characteristic of such regimes is that any underlying concepts are hard to find; either expenditure meets the rules and qualifies for relief, or it does not, and no relief is available. Looking at recent cases, it seems both taxpayers (e.g. Hadee Engineering Co Ltd [2021] TC 07969) and HMRC (e.g. Quinn (London) Ltd [2021] TC 08321) find this difficult; but, for all sides, if you don't like the rules, argue for the rules to be changed, don't try to argue they have a higher purpose, probably discernible only to you.

Another consequence of a rules-based approach is that it can lead to bureaucratic, 'box-ticking' compliance. This has dangers to both taxpayers and tax authorities; taxpayers may find the compliance too exacting, and not claim reliefs. However, tax authorities can also become susceptible to those willing to 'tick the boxes' on a client's behalf, sometimes with little regard for the rules; the response to that being, of course, more bureaucracy. Somehow a balance has to be struck between only allowing relief when it is due, and the claiming of relief being disproportionately onerous.

The other question that formed in my mind after working through the reliefs was 'what are the reliefs for'? Notably, nowhere do the rules require qualifying expenditure to be incremental – i.e. only incurred because of the relief. This would be the economist's preferred position – why incentivise through the tax system expenditure that will happen anyway? Having had conversations over the years with those who were involved in designing the reliefs in the first place, I understand that giving relief for incremental relief is just too difficult to operate, and so it was accepted relief would be given for expenditure that would be incurred in any event. Looking at some of the cases that have come before the Courts, it seems to me that much of the relief (correctly given) in those cases is on work which would have been necessary with or without the relief.

At the recent CIOT Parliamentary Reception, Craig Mackinlay MP, a practising CTA, suggested 'bad things' such as tobacco and alcohol should be taxed, and 'good things' e.g. employment, incentivised through the tax system. Whatever your view of this, I think we can safely say that R&D tax reliefs would meet the 'Mackinlay Test' – as they stand, they act as a reward for R&D expenditure, which is generally seen as a 'good thing'.

I would suggest that acting primarily as a reward, rather than an incentive for extra expenditure is not necessarily wrong. Companies that undertake R&D should be more productive than those in similar industries that do not and reducing the cost of capital of the more productive makes some sense.

Moreover, reliefs for R&D are not confined to the UK. There are many countries wishing to incentivise or reward R&D expenditure through the tax system. Whilst it may be more relevant to larger companies than SME's, having R&D tax relief to ensure R&D is carried on in the UK rather than elsewhere is a sensible defensive move.

So, the conclusion of my reflections is this; if R&D tax reliefs are a reward for doing R&D in the UK, the central question is ensuring the reward is at the right level. The rules themselves can be tinkered with to allow an extra category of expenditure here and there, or to make the claim procedure more robust; but what is key is whether the reliefs are too generous – or not generous enough – and that is the main point any reviews should focus on.

Croner-i's recently updated coverage of R&D tax reliefs can be found in Quick Overview at 29000 and In-depth at 714-000.

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