

## contents

Businesses, individuals and the settlements legislation 1011

Service Company Legislation (IR35) & International Issues 1016

New Tax Credits 1020

### interpretations

Reimbursement of Employees Training Expenses 1022

Flat Rate Scheme For Small Businesses 1023

Farming: Herd Basis-Minor Disposals without Replacement 1024

### miscellaneous

Certificates of Tax Deposit 1025

Inland Revenue R185 Forms 1025

Continuing obligations to deduct tax at source when a late Budget is held 1026

Annual limits for ISA's 1026

Employment Agencies operating in the Netherlands - Double Taxation Agreement 1026

Extra Statutory Concessions & Statements Of Practice

*Tax Bulletin is also available on the Inland Revenue Website at [www.inlandrevenue.gov.uk/bulletins](http://www.inlandrevenue.gov.uk/bulletins)*

# Businesses, Individuals and the Settlements Legislation

## Introduction

We have been asked by the Chartered Institute of Taxation (CIOT) if we would provide some further information and examples on the settlements legislation in Part XV of Income and Corporation Taxes Acts (ICTA) 1988 especially in the context of its application to businesses and individuals. We are happy to do so. We have incorporated a number of comments made by the CIOT on a draft of this article and the examples it contains, but the article remains an expression of the views and practice of the Inland Revenue and the CIOT does not necessarily agree with all the points made.

Unless otherwise stated all references are to ICTA 1988 in this article.

The settlements legislation was originally enacted in the 1930's. The legislation was brought up to date in 1995, further amended in 1999 and can now be found at sections 660A to 660G. The legislation not only applies to trusts but can also apply to other situations involving individuals, companies and partnerships. It is these non-trust situations where we have been asked to provide further information.

**The existing guidance on the settlements legislation is found in the Inland Revenue's Trusts Estates and Settlements Manual which is available on our website at [www.ir.gov.uk/manuals/tsemmanual/](http://www.ir.gov.uk/manuals/tsemmanual/). That manual will be updated to incorporate this additional information shortly.**

The settlements legislation is intended to prevent an individual from gaining a tax advantage by making arrangements which divert his or her income to another person who is liable at a lower rate of tax or is not liable to income tax.

## Definitions

There are two key definitions when considering the settlements legislation, both set out in section 660G(1):

- **Settlement** includes any disposition, trust, covenant, arrangement or transfer of assets. Settlement may include a series of transactions which taken together are regarded as an arrangement. The courts have limited the scope of a settlement to where there is some element of bounty, see "CIR v Plummer [1979] STC 793: 54 TC 1";
- **Settlor** means any person by whom the settlement was made.

There are some important statutory exemptions from the legislation:

- Section 660A(6) exempts situations where the property passed to a spouse is an outright gift, unless;
  - the gift does not carry the right to the whole of the income arising, or
  - the property given is wholly or substantially a right to income.
- Section 660A(9)(a) exempts annual payments made by an individual for bona fide commercial reasons in connection with their trade, profession or vocation.
- Section 660A(9)(b) exempts certain donations made to charities.
- Section 660A(9)(c) exempts income consisting of a benefit under approved pension schemes.

So, in general, the settlements legislation can apply where an individual enters into an arrangement to divert income to someone else and in the process tax is saved. So long as those arrangements are:

- bounteous, or
- not commercial, or
- not at arm's length, or
- in the case of a gift between spouses, wholly or substantially a right to income.

### **Does the legislation only apply to transfers to spouses and minor children?**

It is a common misconception that the settlements legislation applies only to arrangements involving a settlor's spouse or minor children. However, section 660A(2) makes it clear the settlor is treated as having an interest in property if "that property or any derived property is, or will or may become, payable to or applicable for the benefit of the settlor or his spouse in any circumstances whatsoever." It is not necessary for the settlor's spouse or children to be the people to whom the income is transferred. If the settlor or their spouse retains an interest in the property then the legislation can apply. See example 2 below.

Section 660A applies to arrangements where the settlor, or their spouse, retain an interest in the settlement. Section 660B applies to situations where income not caught by section 660A is paid or made available to a minor unmarried child of the settlor. The 1999 amendments extended the legislation to include income otherwise treated as that of the child with regard to settlements made on or after

9 March 1999. For example a settlor who invests money in a savings scheme which is held on bare trust for their child will find the income treated as theirs under this section if the child's relevant settlement income exceeds £100 (section 660B(5)). There are further examples involving children below at examples 8 and 9.

### **How does the legislation apply to non-trust situations?**

A very small percentage of the enquiries we currently undertake each year involve the settlements legislation and non-trust situations. However we do seek tax, interest and penalties in appropriate cases. It is not possible to provide a definitive list of the issues we look for when deciding which cases to take up for enquiry, but some of the factors that the Revenue is looking for might include:

- Main earner drawing a low salary leading to enhanced profits from which dividends can be paid to shareholders who are friends or family members.
- Disproportionately large returns on capital investments.
- Differing classes of shares enabling dividends to be paid only to shareholders paying lower rates of tax.
- Dividends being waived so that higher dividends can be paid to shareholders paying lower rates of tax.
- Income being transferred from the person making most of the profits of a business to a friend or family member who pays tax at a lower rate.

There are a wide range of arrangements that can potentially be caught by the settlements legislation which do not involve a trust. Each case will depend on the facts but some of the most common situations which we see are:

- Shares subscribed at par that carry only restricted rights.
- Shares given away that carry only restricted rights.
- Shares subscribed at par in a company by someone else where the income of the company derives mainly from a single employee.
- A share in a partnership gifted or transferred below value.
- Dividend waivers.
- Situations where dividends are paid only on certain classes of shares.
- Dividends paid to the settlor's minor children.

These lists are by no means definitive of situations to which the settlements legislation can be applied.

The best way to illustrate how the legislation applies is by using the following examples although it should be noted that these are by no means exhaustive.

### Example 1 – Issued shares with restricted rights

An engineering company has 100 ordinary £1 shares. Mr A and Mr B own 50 ordinary shares each. They create a new class of B shares which carry no voting rights and no assets in a winding up. They then issue 50 B shares to each of their wives. Dividends voted on those B shares would be treated as the income of Mr A and Mr B rather than their wives as the B dividends are from shares that are wholly or substantially a right to income and so not exempted from section 660A by section 660A(6). (This example is based on the High Court case of “Young v Pearce; Young v Scrutton [1996] STC 743”).

### Example 2 – Gifted shares with restricted rights

Mr C is the sole director and owns all the 1000 ordinary £1 shares in C Limited. His aunt, Mrs D, has always been very kind to him and he wants to thank her for this. He subscribes, at par, for 100 B shares, with no voting rights and restricted rights to capital of £10 per share in the event of winding up. He gifts the shares to Mrs D. Mr C then declares a dividend of £100 per share with Mrs D receiving dividends of £10,000.

This is a bounteous arrangement and we would apply the settlements legislation to the dividends. The property giving rise to the dividends cannot be looked at too narrowly as the shares alone. The wider arrangement must be considered. Because he is in effective control of the company Mr C retains an interest in the underlying property as he could simply pay all future income arising to himself as director’s salary or as dividends on the ordinary shares.

### Example 3 – Subscribed shares

E Ltd was incorporated in October 1997 to provide the services of Mr E as an IT consultant to a number of clients working in the pharmaceutical industry. The company’s share capital is £2 consisting of 2 £1 shares. Mr E is the sole director of the company, and his wife Mrs E is company secretary but takes no other active part in the company. From the beginning each subscribed for one share. The company has no significant capital assets. The figures for the first year’s trading are: -

Turnover	100,000
Expenses	5,000
Salary (Mr E)	10,000
Salary (Mrs E)	5,000
Dividends	70,000

In this case Mrs E receives a salary for her duties as company secretary, but the whole arrangement whereby Mrs E invests £1 and in return gets a dividend of £35,000 is bounteous. There is nothing to suggest that the dividend is a commercial return on her investment. As there is no significant capital in the company, what has passed from Mr E to Mrs E is substantially a right to income and the whole of the dividend is taxed on Mr E.

In reaching this conclusion, the legislation allows us to look at the whole arrangement. It is the work that Mr E carries out which creates the company’s profits which in turn enable the dividends to be paid. Mrs E’s investment of £1 does not enable the company to make profits and the company itself has minimal capital value. In accepting a salary below the market rate from the company, and thereby allowing some of the income earned to pass to Mrs E as a dividend, Mr E has entered into a bounteous arrangement to divert income to his spouse with the aim of avoiding tax.

### Example 4 – Subscribed shares with little capital value then gifted

As in example 3 but in October 1997 Mr E was not married and subscribed for both £1 shares himself. Mr E’s solicitor was acting as company secretary. A year later he got married and gave his wife one of his shares in the company. At this point Mrs E took over the role of company secretary. In the following year Mrs E receives a wage of £5,000 and the company pays a dividend of £35,000 per share.

Since the capital value of the company is insignificant the gift of the share from Mr E to his wife is not exempt from section 660A by virtue of section 660A(6) as the shares are “wholly or substantially a right to income”. Accordingly the settlements legislation applies in relation to Mrs E’s £35,000 dividend payment and the income would be treated as Mr E’s for tax purposes.

### Example 5 – Partnerships

Mr F and Mr G are in partnership as second hand car dealers. They do not have any premises but buy and sell cars through auctions and the classified adverts of local papers. The partnership’s only assets are some office equipment worth less than £1,000 and they usually have a couple of cars in stock at any one time. They are successful and the profits of £80,000 a year are split equally between them. They decide to admit their wives to the partnership and amend the partnership agreement in order to split profits equally four ways. Mrs F and Mrs G do no work in the partnership and the partnership has no employees.

This is a bounteous arrangement transferring income from one spouse to the other. The settlements legislation will apply and Mr F and Mr G continue to be taxable on half the profits each.

### Example 6 – Dividend Waivers

Where a company with few shareholders declares a final dividend when one or more of the shareholders has waived their right to a dividend in circumstances where other shareholders may benefit, it is possible the settlements legislation could apply.

For example Mrs H owns 80 ordinary shares in H Limited. Mr H owns 20 shares. In 2000 the company made a profit of £25,000. Mrs H waived her right to any dividend. The company then declared a dividend of £1,000 per share, and Mr H, who had no other income, received a dividend of £20,000.

We would apply the settlements legislation in these circumstances. Clearly a dividend of this amount could not have been paid from the company's profits on all the shares, so the waiver arrangement enhanced the dividend paid to Mr H. £16,000 of the dividend paid to Mr H is attributed to Mrs H under section 660A because the waiver was a bounteous arrangement.

### Example 7 – Dividends on certain shares

As in example 6, but in this case Mrs I owns A shares and Mr I owns B shares. Both A and B shares rank equally. Again profits of £25,000 are made and a dividend of £20,000 is voted on the B shares while no dividend is voted on the A shares.

Clearly by not voting dividends on the A shares (which rank equally with the B shares) this is a bounteous arrangement as the dividend paid on the B shares could only be paid if no dividend was declared in respect of the A shares. £16,000 of the dividend paid to Mr I is attributed to Mrs I under section 660A because the decision to only vote dividends on certain shares was a bounteous arrangement.

### Example 8 – Children – gift of shares from parent

Mr J owns all 100 issued £1 shares in J Limited. Mr J is the sole company director and is the person responsible for making all the company's profits because of his knowledge, expertise and hard work. Mr J gives each of his four children 10 shares. Dividends are paid.

Section 660B applies and attributes the dividends paid to the children to Mr J for tax purposes. This is because Mr J has paid the income to his unmarried minor children.

### Example 9 – Children – gift of shares other than from parent

As in example 8, but the 40 shares held by the children were originally owned by their grandmother who had subscribed for them at par when the company was set up but shortly afterwards had gifted them to her grandchildren.

Section 660B applies and attributes the dividends received by the children to Mr J for tax purposes. Since Mr J is the person responsible for making the company's profits and decides on the level of dividends paid, it is Mr J who is the settlor rather than the children's grandmother.

The legislation could apply in a similar way if the children had subscribed for the shares themselves with money received from a third party or even from bank accounts in their own names.

### Where does the legislation not apply?

In most everyday situations involving gifts, dividends, shares, partnerships, etc. the settlements legislation will not apply. If there is no "bounty" or if the gift to a spouse is an outright gift which is not wholly, or substantially, a right to income, then the legislation will not apply. For example:

### Example 10 – An outright gift to a spouse

Mrs L owns 10,000 ordinary shares in a FTSE 100 company. Those shares are worth £40,000. Mrs L gives those shares to her husband. Mr L is now entitled to all the dividends from the shares and can sell the shares if he wants and keep the proceeds. This is an outright gift of shares that are not wholly, or substantially, a right to income since they have a capital value and can be traded, so the settlements legislation does not apply.

### Example 11 – Subscribed shares

Mr M is the sole director and owns all the 100 ordinary shares in M Limited, a small manufacturing company. The company employs 10 people and owns a small factory, a high street shop, tools fixtures and fittings and 3 delivery vehicles. Mr M draws a salary of £30,000 each year and receives dividends of £20,000. Mr M then gifts 50 shares to his wife who plays no part in the business. Mr and Mrs M then each receive dividends of £10,000.

We would not seek to apply the settlements legislation to the dividends received by Mrs M. This is because the outright gift of the shares cannot be regarded as wholly or substantially a right to income. The shares have capital rights and the company has substantial assets so on the winding up or sale of the business the shares would have more than an insubstantial value.

### Example 12 – Subscribed shares

Mr N wants to set up in business as a bookseller. He needs at least £100,000 to buy premises, equipment and stock. He sets up a company and he and Mrs N each subscribe for 40,000 ordinary £1 shares at par and the company borrows £20,000 from the bank. Mr N draws a salary which after four years is £40,000. Mrs N does not work for the company. Company profits are used to repay debt and expand the business. The business does well and after 6 years the profits are sufficient to pay a dividend of £10,000.

We would not seek to apply the settlements legislation to the dividend of £5,000 received by Mrs N. There is no bounty as Mr N draws a commercial salary for his efforts and the dividend is a commercial return on the initial investment which was vital at the commencement of the business and contained a clear element of risk.

### Example 13 – A partnership

Mr and Mrs O and their friend Mr P have a business idea. They want to open a Cycle Repair Shop. Mrs O does not want to work but agrees to invest in the business without taking an active part, that is to say she is a sleeping partner. Each partner invests £10,000 and the £30,000 is used to lease a shop, buy equipment and stock and keep the business going until trade builds up. Under the partnership agreement Mr O and Mr P receive £500 a week with all the remaining profits split three ways between the partners.

The business is a huge success and makes large profits and continues to grow. Within five years Mrs O is receiving £50,000 a year as her share of the partnership profits. Although Mrs O does not work in the business, and her initial investment has turned out to be very successful, the settlements legislation would not apply to treat her share of the partnership profits as Mr O's. Mrs O's original investment was vital to get the business started and she risked losing it if the business failed.

### Example 14 – A partnership

Mr P is a self-employed engineer engaged on specialist work for a number of clients in the construction industry. Mr P employs his wife, who plays an active part in the business including ordering and collecting specialist parts. Mrs P is paid a salary of £20,000. The profits of the business are £40,000. Mrs P owns a substantial property inherited from her mother.

Because of a number of claims made against Mr P, his insurers want to raise premiums by £20,000. He doesn't think he can afford this so his insurers agree to not increase the premiums if Mr P agrees to pay the first £25,000 of any claim. Mr P and Mrs P enter into an equal partnership. Accordingly Mrs P no longer draws a salary but is entitled to

a share of the profits as well as being exposed to the liabilities of the partnership. The property she owns is therefore potentially at risk.

Mrs P's share of the profits is £30,000. Mrs P therefore has extra overall income of £10,000 because she has taken on the risk of the partnership liabilities including that associated with the £25,000 excess on the insurance policy. There is therefore no bounty and the settlements legislation would not apply.

### Example 15 - Gift of shares other than from parent

In 1960 Mr & Mrs Q and Mr & Mrs R set up a small family cleaning company. In total there were, and still are, 100 £1 ordinary shares in the business. Initially Mr Q and Mr R each subscribed at par for 40 shares and Mrs Q and Mrs R each subscribed at par for 10 shares.

When Mr & Mrs Q died they each left their shares in the company (50 in total) to their daughter, Miss Q. When Mr R also died he left his 40 shares in the company to his daughter Mrs S. Miss Q and Mrs S are both directors of the company and carry out its day to day running. The current turnover of the company is approximately £1,000,000 per year and its capital value is over £250,000. Miss Q and Mrs S each receive a salary of £60,000 per year. Each year a dividend of £500 per share is paid.

Mrs R has retained her original 10 shares in the company since 1960. Without discussing the matter in advance with either Miss Q or Mrs S, Mrs R decides to give her shares to her five year old granddaughter who is also Mrs S's daughter. Mrs R makes the gift on her granddaughter's next birthday.

The settlements legislation would not apply to this case since Mrs R retains no interest in the shares which she gives to her granddaughter and is therefore not a settlor within the meaning of section 660G. Nor is Mrs R's decision to gift the shares to her granddaughter part of a wider arrangement with Mrs S to settle income on the child.

## Summary

Whether or not the settlements legislation applies to an arrangement depends on the particular facts of the case. It is necessary to look at the arrangement as a whole. If there is a bounteous arrangement which effectively transfers income earned by one person to another resulting in a reduction in overall tax liability the arrangement may be liable to challenge under the settlements legislation.

A purely commercial transaction or series of transactions at arms length is outside the meaning of 'settlement'. Most commonly the legislation will apply where individuals seek to divert income to members of their family or to friends. A good

test of whether or not the legislation could apply is to consider would the same payments be made to a person who acquired shares in a company or a share of a partnership at arms length. Or whether income is being paid simply because the recipient is your spouse or child or some other individual you might wish to benefit.

If you have any comments on this article and the issues raised you can contact the Editor of Tax Bulletin at the Inland Revenue (address on page 1030) or at the CIOT contact Liz Lathwood, Technical Officer, Chartered Institute of Taxation, 12 Upper Belgrave Street, London, SW1X 8BB.

## Service Company Legislation ('IR35') & International Issues

In relation to references to tax in this article, the terminology of ICTA 1988 has been used rather than that of the Income Tax (Earnings and Pensions) Act 2003.

### 1. Will someone coming to this country from overseas be subject to the service company legislation?

If someone comes to the United Kingdom (UK) and provides their services through an intermediary in such a way that the service company legislation applies, then:

- for tax purposes any income earned in respect of duties performed in the UK is liable to tax in this country (and the relevant Double Tax Agreement (DTA) will, in most cases, confirm this right); and
- for NICs purposes liability normally arises in the country in which the duties are performed, and thus a worker coming to the UK who worked here through a service company would be within the service company legislation. However, the interaction of the UK domestic legislation with international social security treaties means that there are a number of exceptions to this rule and there will be examples where there is no liability for NICs. Only if the notional contract between the worker and the client would result in the worker being an employed earner under the definition in section 2(1)(a) of SSCBA 1992 will the service company legislation bite.

The exceptions to the general rule that liability normally arises in the country in which the duties are performed depend on whether the worker has come from:

- an EEA country;
- a country with which the UK has a reciprocal agreement; or
- a country in the rest of the world

## EEA Countries

**Where a worker comes to the UK from an EEA country to provide services through an intermediary to a client in the UK, then:**

- the worker is liable to UK NICs (article 13(2)(a) of EC Regulation 1408/71); and
- \* the intermediary is the secondary contributor whether or not it satisfies the conditions as to residence or presence in Great Britain. (Reg 6(3)(b) of the Social Security Contributions (Intermediaries) Regulations 2000). Similar Regulations apply in Northern Ireland.

However, there is an exception to this rule if the individual could be regarded as a short-term posted worker. This applies where a worker is engaged to carry out a relevant engagement by a client in another EEA country and is sent by that client to work in the UK. There will be no liability for NICs provided that:

- the posting is not expected to last for a period in excess of 12 months; and
- the worker is not being sent to replace another person who has completed a similar posting.

(Article 14(1)(a))

Case Studies 1 and 2 illustrate the operation of these rules.

In the event of the engagement unexpectedly lasting longer than 12 months the worker may remain outside the UK scheme for a further 12 months subject to the worker obtaining satisfactory certification from the relevant authorities.

## Countries that have a Reciprocal Agreement with the UK

Where the worker was paying social security contributions under the scheme of a country with which the UK has a Reciprocal Agreement for NICs and is sent by the client to work temporarily in the UK, under the terms of the Agreement that worker would not have been liable for UK NICs had he been an employee of the client and thus will not therefore be subject to the service company legislation.

## Rest of the World Countries

If an individual was normally resident in a country which is neither an EEA country nor one with which the UK has a reciprocal agreement and services are provided to a client in the UK, then NICs may not be payable for the first 52 weeks

from the date of entry into the UK. If he is still engaged in the UK after 52 weeks then liability for UK NICs under the service company legislation will arise from the 53rd week. Case Study 3 illustrates this situation.

## 2. Will someone who provides services to a client overseas be subject to the service company legislation?

If someone provides their services through an intermediary to a client overseas in such a way that the service company legislation applies, then they may have to pay tax and NICs under that legislation.

For **tax** purposes, chargeability will depend on the residence status of the worker and the country in which the services are performed. The legislation provides for the worker to be taxed on the basis of the Schedule E treatment that would have arisen if he/she had been engaged directly by the client.

For **NICs** purposes, the intermediaries legislation only applies where the worker would be regarded for the purposes of Parts 1 to V of the Social Security Contributions and Benefits Act 1992 as employed in employed earners employment by the client, had the arrangements taken the form of a contract between the worker and the client.

However, there are exceptions to the general rule, which depend on whether the individual is providing services to a client:

- in an EEA country;
- in a country with which the UK has a reciprocal agreement
- in a country in the rest of the world

### EEA Countries

Any worker employed in the territory of one EEA country is subject to the legislation of that country even if he resides in the territory of another country or the registered office or place of business is situated in the territory of another EEA country. Therefore, a worker providing services to a client in an EEA country other than the UK would be liable to pay social security contributions according to the EEA country in which he is employed and would not be an employed earner in the UK under sec 2(1) of SSCBA 1992. Consequently, the service company legislation would not apply for NICs purposes. However, there is an exception to this rule if the individual could be regarded as a short-term posted worker.

Case Studies 4 and 5 illustrate the operation of these NIC rules.

### Countries that have a Reciprocal Agreement with the UK

Under Reciprocal Agreements with certain countries outside the EEA, a worker will pay social security contributions in the country where he is working. The UK has entered into 19 such agreements. Therefore, a worker providing services to a client in a country with which the UK has a reciprocal agreement will be liable to pay social security contributions according to the country in which he is employed and he would not be an employed earner in the UK. Therefore, the service company legislation would not apply for NICs purposes.

However, within each RA a provision allows for a posted worker to remain insured in the UK for National Insurance purposes for a limited period. Each RA sets out the time limit. In this situation the individual would remain within UK NICs because he would be a posted worker, but this is because he is, as a matter of fact, an employee of his service company. It does not bring him into the scope of the service company legislation because that is based on the position which would apply if he were working directly for the overseas client without the interposition of an intermediary.

Case Study 7 illustrates the operation of these NIC rules.

### Rest of the World Countries

Any worker providing services to a client in a country in the rest of the world would be liable for contributions according to the country in which he is employed and he would not be an employed earner in the UK. Therefore, the service company legislation would not apply for NICs purposes.

Case Study 6 illustrates the operation of these rules.

## 3. What are the residence rules?

The **tax** liability is determined by the residence status of the worker and also the location in which the duties of the relevant engagements are performed. The rules are quite complex (see IR20), but the various permutations can be summarised as follows:

UK residence status of employee	Duties of employment performed either wholly or partly in the UK		Duties of employment performed wholly outside the UK
	Performed in the UK	Performed outside the UK	
Resident and Ordinarily Resident	Case I (taxable on all earnings, whether duties performed in the UK or overseas)	Case I	Case I. If the emoluments are foreign emoluments, Case III
Resident but Not Ordinarily Resident	Case II (taxable only on duties performed in the UK)	Case III (taxable only on earnings remitted to the UK)	Case III
Not Resident but Ordinarily Resident	Case II	No liability	No liability
Not resident and Not Ordinarily Resident	Case II	No liability	No liability

#### 4. What about Double Taxation Agreements (DTAs)?

The UK has entered into DTAs with most countries but the terms of these generally mean that, where a worker provides services in the UK, the UK retains its taxing rights over the deemed payment in respect of duties performed in the UK for the client.

There will be a few exceptions, such as where the work done in the UK is merely incidental to the work done abroad, or where the worker is a 'short term business visitor' (i.e. in the UK for less than 60 days in a tax year where that period does not form part of a more substantial period where the worker is present in the UK).

#### 5. International Case Studies

##### Case Study 1 – Worker resident in Ireland/working in UK

Ms A is resident in Ireland without also being resident in the UK. She provides her services through a service company also resident in Ireland. The services are provided to an UK resident client in the UK.

##### **Tax**

According to the Irish DTA, any emoluments paid in respect of duties performed in the UK will be chargeable to tax under Case II of Schedule E. The UK will retain taxing rights unless the merely incidental test or 60 day rule are satisfied.

##### **NICs**

As Ms A is an EC national and works in the UK for a UK client she is liable for UK NICs and there would be NICs liability under the service company legislation.

However, there is an EEC Council Regulation which allows a person to remain insured in Ireland for 12 months (with the possibility of a further 12-month extension) if he/she is a 'posted worker'. The intermediary in Ireland can obtain a certificate form E101 from NICO International Services, and the person will not be liable for UK NICs. In this situation, the service company legislation would not apply for NICs purposes because the worker would not be an employed earner if engaged directly by the client.

##### Case Study 2 – Worker resident in France/working in UK

Mr B is resident in France and provides his services through a service company also resident in that country. The services are provided to an UK resident client in the UK.

##### **Tax**

The wording of the French DTA has the same effect as for Ireland.

##### **NICs**

The same EEC Council Regulations apply to all EEA countries including France so the situation will be the same as for Ireland.

### **Case Study 3 – Worker resident in Australia/working in UK**

Mr C is resident in Australia and provides his services through a service company also resident in that country. The services are provided to an UK resident client in the UK.

#### **Tax**

The wording of the Australian DTA has the same effect as for Ireland.

#### **NICs**

There is no reciprocal agreement between the UK and Australia for NICs. If a worker is resident in Australia and provides his services to a client in the UK then contributions may not be payable for the first 52 weeks from the date of entry into the UK if the conditions of regulation 145(2) Social Security Contributions Regulations 2001 are satisfied.

If the worker is still engaged by the client in the UK after 52 weeks then there will be a NICs charge under the service company legislation on both the individual and the intermediary, from the end of this period.

### **Case Study 4 – Worker resident in UK/working in Ireland**

Mr D is resident in the UK without also being resident in Ireland. He provides his services through a service company also resident in the UK. The services are provided to an Irish resident client in Ireland.

#### **Tax**

The DTA between the UK and Ireland will apply to an UK resident worker providing services to a client in Ireland in the same way as to an Irish resident worker providing services to a client in the UK.

The UK continues to have a right to tax the deemed payment because it is the country where the worker remains resident. However, Ireland may also tax a UK resident worker's remuneration derived from employment exercised in Ireland unless the relevant conditions in the DTA are satisfied. The extent to which the income falling within the service company legislation is also taxed in Ireland will depend on Irish domestic law.

Where the income of an UK resident worker in respect of duties performed for a client in Ireland is correctly taxed in both Ireland and the UK, then the UK, as the country where the worker is resident, will give credit for the Irish tax against the UK tax chargeable on the same income. Further information on this can be found on the Revenue website, IR35 section at FAQ (Foreign) Q.6.

#### **NICs**

A contract involving a worker living in the UK and an Irish client, under which he works in Ireland means he is liable to pay Irish social security contributions. He would not be an employed earner for the purposes of UK National Insurance legislation. Therefore the service company legislation would not apply for NICs purposes.

Under the short term posting exception a worker may continue to pay UK NICs where they are working through a service company in the UK which posts them overseas to work for a client in any country in the EEA for not more than 12 months. The intermediary obtains form E101 from NICO International Services. Under certain circumstances the 12-month period may be extended for a further 12 months and an E102 obtained.

The intermediary can obtain form E101 from NICO International Services and the worker is classed as a posted worker. He would be regarded as an employed earner for the purposes of the UK National Insurance legislation by reason of the contractual arrangement between the intermediary, the worker and the client. However, the service company legislation does not apply because in deciding whether it applies you consider what the situation would have been if the intermediary had not been involved. In these circumstances the worker would not have been an employed earner of the client.

However, there is a further exception to this rule where a person is employed in two or more Member States. If so, they are subject to the legislation of the Member State in which they reside. So there would be a NICs liability under the service company legislation in these circumstances.

### **Case Study 5 – Worker resident in UK/working in France**

Mrs E is resident in the UK without also being resident in France. She provides her services through a service company also resident in the UK. The services are provided to a French resident client in France.

#### **Tax**

The wording of the French DTA is the same as for Ireland so the same position will apply.

#### **NICs**

The same EEC Council Regulations apply to all EEA countries including France so the situation will be the same as for Ireland.

### **Case Study 6 – Worker resident in UK/working in Australia**

Mr F is resident in the UK without also being resident in Australia. He provides his services through a service company also resident in the UK. The services are provided to an Australian resident client in Australia.

#### **Tax**

The wording of the Australian DTA has the same effect as that for Ireland.

#### **NICs**

There is no reciprocal agreement between the UK and Australia for NICs. A contract involving a worker living in the UK and a client in Australia under which services are provided in Australia would mean he would be liable to pay Australian social security contributions. He would not be an employed earner under UK National Insurance legislation. The service company legislation will not apply for NICs purposes.

However, if the worker was resident and ordinarily resident in the UK immediately prior to the posting to Australia by the intermediary and the client had a place of business in the UK he would be treated as an employed earner for the first 52 weeks from the date of posting or the duration of the contract if earlier. There would be no NIC liability if the 52-week period ended before the 5th April in the year of assessment.

### **Case Study 7 – Worker resident in UK/working in USA**

Mr G is resident in the UK without also being resident in the USA. He provides his services through a service company also resident in the UK. The services are provided to an American resident client in the USA.

#### **Tax**

The wording of the USA DTA has the same effect as that for Ireland.

#### **NICs**

A contract involving a worker living in the UK and a client in the USA under which he works in that country means he would be liable to pay US social security contributions. He would not be an employed earner under UK National Insurance legislation. The service company legislation will not apply for NICs purposes.

There is a reciprocal agreement (RA) between the UK and the USA for NICs. Within each RA a provision allows for a posted worker to remain insured in the UK for National Insurance purposes. Each RA sets out the time limit. For example, the time limit for the USA is 5 years.

The intermediary can obtain a certificate of continuing liability from NICO International Services. The worker on posting by the intermediary to the USA would be regarded as an employed earner under UK legislation by reason of the contractual arrangement between the intermediary, the worker and the client. However, the service company legislation will not apply because in deciding whether the legislation applies you consider what the situation would have been if the intermediary had not been involved.

## **New Tax Credits**

### **Introduction**

Two new tax credits, Working Tax Credit and Child Tax Credit, are being introduced from 6 April 2003. Working Tax Credit (WTC) replaces, among other things, the adult elements of Working Families' Tax Credit (WFTC) and the Disabled Person's Tax Credit (DPTC). It is for working people, whether or not they have a child, and for the first time this type of financial support will be available to non-disabled working people without children. WTC consists of various elements, including a child care element to help with the costs of eligible child care. Apart from the child care

element, WTC will normally be paid to employees by their employers with salary, in much the same way as WFTC and DPTC were.

Child Tax Credit replaces the child-related elements of WFTC and DPTC, as well as the Children's Tax Credit and will be paid to families both in and out of work. Along with the child care element of WTC, it will be paid by the Revenue direct to the person in the family who is mainly responsible for looking after the children.

The arrangements for paying WTC through employers are broadly similar to those for WFTC/DPTC. However, there are a number of differences, the two most important from the employer's point of view being that

- instead of the six-month WFTC/DPTC awards, WTC and CTC are awarded for up to a year, ending on 5 April, in line with the tax year; and
- unlike WFTC and DPTC, awards of the new tax credits can change in-year in response to changes in the claimant's income or circumstances.

A new guide for employers, *Paying Working Tax Credit with wages* (E6), is available from the Employer's Orderline on 08457 646 646 or on the Inland Revenue website at [www.inlandrevenue.gov.uk/pdfs/emp2003/e6\\_2003.pdf](http://www.inlandrevenue.gov.uk/pdfs/emp2003/e6_2003.pdf).

### **Overpayments of WTC by employers**

Whereas WFTC and DPTC were awarded for six months at a time and remained payable for the full six months of the award, even if the recipient stopped working in that time, WTC is payable only while the claimant is actually in qualifying remunerative work. It is therefore possible that employers might, through no fault of their own, pay too much WTC to an employee, for example, if the employee leaves his job.

The following paragraphs explain what will happen if we find that an employer has paid too much tax credit to an employee in specific circumstances.

#### **When an employee leaves**

Under the old tax credits system, if an employee receiving WFTC or DPTC through the payroll left his job, the employer could choose whether to pay the tax credit up to the date of leaving or up to the end of the pay period in which the date of leaving fell. This choice was possible because the fixed tax credit award continued for six months even if the recipient stopped working.

However, if an employee receiving WTC stops working, his entitlement to WTC may cease, unless he starts another job within seven days. So the employer should not pay WTC beyond the employee's date of leaving.

An employer may inadvertently pay the employee beyond his last day of employment, for example, because the payroll department has not been made aware that the employee has left. If this happens, the employer or payroll department should, within seven days of finding out that the employee has left, call the Employer's Helpline on 08457 143 143 to report the latest day for which WTC has been paid to this employee. (Regulation 12(8) of The Working Tax Credit (Payment by Employers) Regulations 2002 covers this situation.) Provided he does this, the employer will not be held responsible for the overpaid tax credit, that is, WTC paid in respect of any day after the date of leaving.

### **When an employee dies**

Similarly, an employer or payroll department may not know that an employee has died and may pay tax credit beyond the date of death. Within seven days of becoming aware that this has happened, he should call the Employer's Helpline on 08457 143 143 to report the latest day for which he has paid tax credit to this employee. (Regulation 12(7) of The Working Tax Credit (Payment by Employers) Regulations 2002 refers.) Provided he does this, the employer will not be held responsible for the overpaid tax credit, that is, WTC paid in respect of any day after the date of death.

### **When an employer does not receive an amendment or stop notice**

Because tax credit awards respond to in-year changes in a claimant's household income or circumstances, we will sometimes need to ask an employer to amend the daily rate of WTC that he pays or to stop paying tax credit to an employee altogether. In these circumstances we will send the employer an amendment notice or a stop notice, giving him 42 days to amend the daily rate or such shorter period as may have been agreed between us and the employer in the case of a notice to stop paying WTC.

If an employer tells us that he has not received an amendment or stop notice that we have sent, and has continued to pay tax credit at the old daily rate, the employee may receive an overpayment of WTC. Provided we have no reason to doubt the employer's word, we will assume that the amendment or stop notice was lost in the post. We will deal with any overpayment arising in these circumstances by contacting the claimant rather than seeking to recover it from the employer.

### **Mistakes by the Revenue**

If we make mistakes that lead to an employer paying too much tax credit to an employee, we will sort things out with the employee concerned. For example, we may have told the employer to pay too high a daily rate of WTC. A code of practice setting out how we will deal with claimants who have been overpaid tax credits will be published later this year and will then be posted on the Revenue website.

Provided the employer has paid exactly the amount of WTC that we have told him to pay (on a start, amendment or restart notice), we will not hold him responsible for any overpayment arising from our mistake.

### Avoiding overpayments

Under regulation 6(10) of The Working Tax Credit (Payment by Employers) Regulations 2002, if an employer pays more tax credit than he should in one pay period, he may recover the excess from the employee, for example, by paying less tax credit in the next pay period. This is a relaxation of the rule for WFTC and DPTC, under which employers were told to recover such overpayments as overpaid wages.

## interpretation

### Reimbursement Of Employee's Training Expenses – Training Undertaken Before Employment Begins – Section 250 ITEPA 2003

1. Section 250 ITEPA 2003 (formerly, Section 200B ICTA 1988) provides exemption from tax when an employer pays or reimburses the costs of an employee's "work-related training" (as defined). The exemption also applies for National Insurance contribution purposes via paragraph 2, Part VII, Schedule 3, Social Security (Contributions) Regulations 2001.

2. We believe some inconsistency may have arisen regarding the application of this provision when an employer reimburses, to a new employee, the expense of a training or academic course begun or completed before the commencement of the employment. This article explains that such reimbursements will not, normally, qualify for exemption. It also sets out some limited circumstances in which the reimbursement of pre-commencement training expenses will qualify.

### Background

3. Without a specific exemption, an employer's reimbursement of training expenses paid out of an employee's own pocket would be taxable as "general earnings" within Section 6 ITEPA 2003. The payment would constitute earnings within Section 62, or would be treated as earnings by Section 72. No deduction would be due under Section 336 (formerly, Section 198 ICTA 1988) because the expense will not have been incurred "in the performance of" the employee's duties (*Fitzpatrick v CIR*, 1994 STC 237,66 TC 407).

4. The situation outlined in the previous paragraph led to the publication of an Extra Statutory Concession (A63) under which training costs met or reimbursed by an employer were

not taxed provided that certain conditions were met. For 1997/98 onwards the concession was replaced by Section 200B ICTA 1988, which was significantly wider in scope than the previous concession. Section 200B has now been rewritten as Sections 250 and 251 ITEPA 2003.

### Application of Section 250 to Pre-Employment Training

5. In order to qualify for exemption under Section 250 ITEPA 2003 the reimbursement must relate to the cost of "work-related training". Work-related training is defined in Section 251 (formerly, Section 200B(5) and (6) ICTA 1988). The definition includes, inter alia, training for a future job with the employee's employer but does not, except in very limited circumstances (see para 9 below) cover the reimbursement by a new employer of training expenses incurred by the employee before the employment began.

6. Looking first at the provisions of ICTA 1988, the exemption applied to expenditure incurred by the employer on providing such training for "a person ... who holds an office or employment under him" (Section 200B(1)). That employment condition applied equally, as regards the employee, to the reference at Section 200B(6)(a) to "any office or employment which he ... is to hold under the employer (or a related employer)". The condition is underscored by the words "in relation to the employee" in the introductory words of Section 200B(6).

7. That position is reproduced in Section 251 ITEPA 2003, where work-related training is defined in terms of the employment which the employee holds, or another employment with the same employer (or a person connected with the employer).

8. The legislation does not provide a general exemption for reimbursements of training costs incurred by individuals before they commenced employment. The Special Commissioners' decision in *Silva v Charnock* (SpC332), where the facts were somewhat unusual, does not provide support for any such general proposition.

9. We recognise, however, that cases will arise where the link between the employment and the pre-commencement training is so strong that the reimbursement should also qualify for exemption. For example, if an individual has accepted an employment offer from a new employer, to start work in the reasonably near future, and the individual then pays for work related training (within Section 251(1)) for that job, exemption will not be denied if the employer agrees to reimburse those costs after the employment has begun. If there is no such demonstrable link between the individual's undertaking the training and the particular employment that they subsequently obtain, the reimbursement of the pre-employment training costs will continue to be outside the exemption.

## The Way Forward

10. It is possible that some inconsistency in treatment may have arisen in this area. Some employers may, on tax office advice, be taxing (and NICing) the reimbursement of pre-employment training or academic fees, whilst others are not. We apologise for any discrepancies in treatment that may have arisen as a result.

11. In some cases tax offices may have told employers, or practitioners, that the reimbursement of pre-employment training or academic fees can always be paid tax and NIC free by virtue of Section 200B(1) ICTA 1988 (now, Section 250 ITEPA 2003). In those cases the tax office will write to the employer or practitioner concerned letting them know that payments in circumstances which are clearly outside the criteria mentioned in paragraph 9 will be subject to both PAYE and National Insurance contributions. But they will also make it clear that the Revenue will not pursue arrears of tax, or NICs, in cases where:

- payment has been made gross in accordance with specific Revenue advice, or
- an employer who has received incorrect Revenue advice makes payments “gross” in fulfilment of an existing undertaking given in reliance on that advice.

12. Individuals who believe that their National Insurance contribution record may be adversely affected by the Revenue’s decision **not** to recover arrears in the circumstances mentioned above should contact their National Insurance Contributions Office. Employers and employees who think, in the light of this article, that exemption has been wrongly withheld in the past should contact their own tax office.

---

## Flat Rate Scheme For Small Businesses

---

In Tax Bulletin issue 61 we published an article on the implications of the VAT flat rate scheme for the computation of profits under Schedule D Cases I and II. Subsequent comment on that article has pointed up problems with the views we expressed.

We will include new revised material on the VAT flat rate scheme in our published guidance manuals for Revenue staff. An advance copy of this revised material is set out below, and the Tax Bulletin article in issue 61 is accordingly superseded.

### Flat rate scheme for small businesses

An optional flat rate scheme was introduced with effect from 24 April 2002 by FA2002/S23. At the introduction date the scheme was available to all small businesses

- with a VAT exclusive annual taxable turnover of up to £100,000, and
- with a VAT exclusive annual turnover, including the value of exempt supplies and other non taxable income, of up to £125,000.

Both the above requirements apply at the point of entry into the scheme. Businesses check turnover each anniversary of joining the scheme, if it is over £150,000 VAT inclusive they must leave the scheme.

A business that joins the scheme avoids having to account internally for VAT on all purchases and supplies, and instead calculates its net liability by applying a flat rate percentage to the tax inclusive turnover. The flat rate percentage depends on the trade sector into which a business falls for the purposes of the scheme. There is a wide spread of applicable percentages ranging (on introduction of the scheme) from 5% to 14.5%.

Under the flat rate scheme businesses

- continue to charge their customers the normal rate for the supply (i.e. not the flat rate percentage) on all taxable supplies of goods or services
- issue tax invoices to their VAT registered customers, and also to all other customers if the business chooses to do so (these invoices show the normal rate for the supply and are used for the customers VAT reclaim).

They do not have to record all the details of the invoices issued or purchase invoices received to calculate the amount of VAT they must pay to Customs.

### Capital assets

If capital assets are purchased with a VAT inclusive value of £2,000 or more, the VAT can be recovered in the normal way. This concession, however, cannot be used where the assets were

- acquired for resale, or for incorporation in goods to be sold
- acquired to be hired out, leased or let
- for consumption within one year, or
- covered by the capital goods scheme.

### Further information

Full details of the scheme are included in VAT Notice 733 Flat rate scheme for small businesses, which is available on the internet at [www.hmce.gov.uk/forms/notices/733.htm](http://www.hmce.gov.uk/forms/notices/733.htm) or in printed form by telephoning Customs’ National Advice Service on 0845 010 9000.

## Computation of profits Case I/II Schedule D

The flat rate scheme removes the necessity to calculate VAT on each individual input and output for the VAT account. Instead only the flat rate VAT will need to be passed to the VAT account. Where the concession for capital assets is adopted, the VAT reclaimed will also pass through the VAT account.

Expenses will probably be shown inclusive of VAT as it is irrecoverable (similar to a business not registered for VAT), and it is likely that turnover will be shown net of the flat rate VAT payment. You may however find that the flat rate VAT payment is shown as a profit and loss expense rather than deducted from total turnover.

Where there is irrecoverable VAT on capital items it will form part of the cost of the asset on the balance sheet and of the cost for capital allowances purposes.

### Example

A business has gross sales of £94,000 (including output VAT at 17.5% of £14,000), and expenses of £58,750 (including irrecoverable VAT). The flat rate VAT @ 6% is £5,640. A new machine is purchased (qualifying for capital allowances) at a cost of £2,350 including VAT of £350.

The accounts will show:

Turnover	£88,360	(£94,000 less £5,640 flat rate VAT)
Expenses	£58,750	
Profit	£29,610	

If VAT is not reclaimed on the asset the cost for capital allowances purposes will be £2,350. If VAT is reclaimed the cost will be £2,000.

## Service companies ("IR35") legislation - deemed payment calculation

The amount to be included under Step 1 of the deemed payment calculation is the VAT exclusive amount whether or not the flat rate scheme is adopted. For the intermediary within the flat rate scheme in the example above the VAT exclusive amount would be £88,360. Irrecoverable VAT relating to allowable expenses met by the intermediary would be allowable as part of the expenses in the same way as if the intermediary was not VAT registered.

## Farming: Herd Basis: Minor Disposals Without Replacement

The profit arising from minor disposals without replacement is chargeable by virtue of ICTA88/Sch 5/Para 3(10). Following

representations, we have reconsidered our interpretation of this legislation.

### Herd Basis Cost

We no longer consider it necessary or appropriate to compute the profit on a minor disposal from a herd, without replacement, using what we have previously described as the "herd basis cost". In our previous interpretation of the herd basis provisions, the "herd basis cost" consisted of the initial cost of the herd and the cost of any improvement or increase in herd size. These costs were not and still are not deductible in the farm trading account. When an animal replaced another of the same quality it took on the "herd basis cost" of its predecessor.

### Minor Disposal: No Replacement

We consider a disposal amounting to less than 20% of the herd to be minor. Profits on these disposals are taxable (paragraph 3(10)). In the past we computed this profit by reference to "herd basis cost". In old established herds the original animals would have been replaced, perhaps several times, and this brought into charge a profit largely due to inflation. On our revised view of the situation where a farmer sells, without replacement, a small part of the herd we accept the profit should be computed by reference to the actual cost of the animal or animals disposed of. The fact that an animal taken from the herd replaced an earlier one is no longer relevant.

The following example illustrates the practical effect:

Jim has been a dairy farmer since 1950. He started his herd with an initial purchase of 60 cows costing £100 each. Over the years he has maintained his herd by regularly replacing his stock with animals of the same quality.

In 2002, at the age of 70, he decided to sell 10 of his most recently purchased cattle without replacement. The sale proceeds were £5500 in total. As this disposal amounted to less than 20% of the herd the profit needs to be included in the trading account of the farm by virtue of paragraph 3(10). The "herd basis cost" of these animals would have been £100 each, but they actually cost him £450 each.

Using the "herd basis cost" the profit would have been  $£5500 - (10 \times 100) = £4500$ .

Using actual cost the profit becomes  $£5500 - (10 \times 450) = £1000$ .

The computation of the profit at £1000 accords with our current interpretation of paragraph 3(10).

In a situation where the farmer's records are simply so bad that this identification is not possible, we will accept that the cost of the animals removed be computed by reference to

the BEN19 formula applied to the sale price. In this case it would work out at £3300 (60% of £5500). The chargeable profit would then be £2200.

Our guidance to Inspectors is currently being rewritten to reflect this change of view. We will accept this revised interpretation both in returns received from the date of this Tax Bulletin article and for returns already received where the liability can be recomputed under the normal Self Assessment provisions.

## ***miscellaneous***

### **Certificates of Tax Deposit**

---

The Certificate of Tax Deposit Prospectus (Series 7) has been revised and the amended version can now be found on the Inland Revenue Internet website by accessing 'Individuals' and then 'Frequently asked questions'.

The revisions are as follows:

- The Initial purchasing value for a Certificate of Tax Deposit (CTD) has been reduced from £2000.00 to £500.00 and the top-up value for additional CTD's has been reduced from £500.00 to £250.00.
- National Insurance Class 4 has now been added to the schedule of liabilities that can be paid by a CTD.
- A change has been made to the terms surrounding the purchasing of partnership CTD's. From 6th April 2003 only CTD's purchased from this date in partners individual names will be accepted as payment against a partners individual tax liability. CTD's purchased from 6th April 2003 in a partnership name will only be accepted as payment against assessed partnership tax liabilities.

For further information regarding the terms and conditions for purchasing CTD's in order to make provision for future tax liabilities please refer to the Prospectus.

---

### **Inland Revenue R185 forms**

---

We have reviewed some of our R185 series forms. The result is that we have deleted some old forms and improved another, and have produced two new forms. The details are as follows. The new and improved forms will be available from June 2003

#### **Old trust forms**

Trustees of discretionary trusts used form R185 to notify beneficiaries of payments made to them, and the associated tax credit.

Trustees of interest in possession trusts used form R185 (Non discretionary trust) or R185 (Non-discretionary trust)(1999) to notify beneficiaries of their entitlement to income for the year and the associated tax credit.

#### **New trust form R185 (Trust Income)**

We have now combined the discretionary trust part of the old R185 with the old R185 (Non-discretionary trust)(1999) and produced one form for both types of trust. The new form is called the R185 (Trust Income). The old R185 (Non-discretionary trust) and R185 (Non-discretionary trust) (1999) forms will no longer be needed.

The new form can be used by trustees of discretionary and interest in possession trusts to notify beneficiaries about income and any tax credit. The beneficiaries can use the information in the form to complete their SA returns or claim repayments. To improve customer service, the new form uses the same box numbers as on the trust income pages of the SA return. Non-SA taxpayers can also use the information on the new forms to make claims.

You will find the R185 (Trust Income) on the Internet at [www.inlandrevenue.gov.uk/pdf/r185\\_trust.pdf](http://www.inlandrevenue.gov.uk/pdf/r185_trust.pdf)

#### **Improved estates form R185 (Estate Income)**

We have also looked again at the R185 (Estate Income), used by personal representatives to inform beneficiaries of their income entitlement from the estate. We have revised this form to make it clearer. And like the new trust form, the improved estates form uses the same box numbers as on the trust income pages of the SA return.

You will find the new R185 (Estate Income) on the Internet at [www.inlandrevenue.gov.uk/pdf/r185\\_estate.pdf](http://www.inlandrevenue.gov.uk/pdf/r185_estate.pdf)

#### **Approval of substitute trust forms**

Trustees and forms producers do not have to apply to the Inland Revenue for 'approval' of substitutes R185 (Trust Income) and R185 (Estate Income).

#### **New non-trust form R185**

The old R185 was used not only to notify payments from discretionary trusts, but also other annual payments such as loan interest and rent.

We decided to produce a separate form to cover the non-trust aspects. The new form is called the R185. You will find the new R185 on the Internet at [www.inlandrevenue.gov.uk/pdf/r185.pdf](http://www.inlandrevenue.gov.uk/pdf/r185.pdf)

Tax deducted from rent paid to a non-resident landlord should be notified on form NRL6 which is available on the Internet at Centre for Non residents/Non resident landlords/Forms and leaflets/NRL6.

## Continuing Obligations To Deduct Tax At Source When A Late Budget Is Held

In both 2002 and 2003 the Chancellor has not announced his Budget Proposals until after the start of the relevant tax year. But financial institutions and other intermediaries which have any type of obligation to deduct or account for tax, need to know which rate(s) to apply as from 6th April.

Our advice is that they should continue to deduct or account for income tax at the existing rate(s) until such time as the Chancellor makes his proposals. Full guidance can be found on the IR website at [www.inlandrevenue.gov.uk](http://www.inlandrevenue.gov.uk)

## Annual Limits For ISA's

A late budget could make life very hard for savings providers in the event of amendments to ISAs. However, ISA limits were announced in the 2001 Budget for all years up to 2006.

## Employment agencies operating in the Netherlands

Many employment agencies now operate internationally. This article deals particularly with those supplying workers to work in the Netherlands as we have received several requests for clarification and information.

The domestic tax system in the Netherlands provides in broad terms that remuneration for work done in the Netherlands may be taxed there (as does the parallel UK legislation at S19 ICTA 1988). The worker does not have to be a Dutch resident.

## The Double Taxation Treaty

We have a Double Taxation Treaty with the Netherlands. This confirms their general taxing right at Article 15(1):

*"..... wages and other similar remuneration derived by a resident of one of the States in respect of an employment shall be taxable only in that State unless the employment is exercised in the other State. **If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.**"*

But the second paragraph of this Article provides a let-out for short-term business visitors from the UK where their earnings will not end up being a deduction against Netherlands tax. UK residents who work in the Netherlands will be solely liable to tax in the UK provided all of the following criteria are satisfied:

- they are not in the Netherlands for more than 183 days in total in the Dutch tax year, 1st January to 31st December;
- their wages are not a deduction for a Netherlands employer; and
- their wages are not borne by a permanent establishment or fixed base that a non-resident employer has in the Netherlands.

If an agency is supplying workers to a Dutch company the Netherlands Tax Authority (NTA) may decide that these conditions are not fulfilled. However this will depend on the precise facts of the case. **The agency is encouraged to seek early advice from the NTA.**

There are a number of issues surrounding these provisions which may cause confusion.

## 183-day rule

It is important to note that people working in the Netherlands may be taxed on their employment income either because they are resident in the Netherlands for tax purposes or because one or more of the three conditions for exemption from Dutch income tax does not apply. The 183-day rule is only one of the conditions to be satisfied to preclude taxation in the Netherlands.

## Who is the employer?

If a UK agency hires out staff to a company in the Netherlands, the individual concerned has a formal contract of employment with the agency, but he or she works in the business of the Dutch company, which obtains the benefits and bears any risk in relation to the work undertaken. In economic terms this is represented by the UK agency recharging the cost of the employee's remuneration to the Netherlands, and the Dutch company might be described as the 'economic employer'.

As a general rule, the Dutch will use a more formal approach, in which an important factor is where the employment relationship exists. In their civil law, this will be with the employment agency. However, in some cases they will use an economic employer approach, if the factual circumstances of the case warrant it. Because it is sometimes difficult to see in advance whether there will be tax obligations in the Netherlands, the NTA advises that Netherlands wages tax should be withheld from the worker from day 1. In cases where it appears afterwards that no Netherlands tax is due the worker can claim the tax back by filing an income tax return.

## Agency obligations in the Netherlands

Employers that are situated in the Netherlands, or which have a permanent establishment [p.e.], in the Netherlands are obliged to withhold a wage tax. This wage tax must be withheld on a periodic basis - in most cases monthly or every four weeks - and serves as an advance levy on the final income tax assessment. Also employers are obliged to withhold social security premiums. For Dutch national tax purposes, the (foreign) employment agency is the employer.

The wage tax is calculated on a periodic base on the assumption that the employee works the whole year. If that assumption is not correct the income tax finally due can differ from the wage tax withheld, resulting in additional payments or money back for the taxpayer. The same thing can happen because of special deductions or expenses that are not taken into account when calculating the wage tax.

From 1 January 1997 legislation was introduced in the Netherlands whereby foreign Employment Agencies who provide workers in the Netherlands are deemed to have a permanent establishment for wage tax purposes in the Netherlands. This is solely an administrative mechanism for collection of Dutch wages tax: it does NOT of itself mean that the UK agency has a permanent establishment for any other purpose. As such, Employment Agencies are treated as withholding agents for wage tax purposes and are therefore obliged to withhold wage tax (and also social security contributions) on behalf of their employees from the first day of their employment in the Netherlands.

In most cases it will be clear that the worker will be liable for wages tax in the Netherlands. If there is no tax treaty between the Netherlands and the other State it will only be Dutch national legislation that can apply. Then the worker will always be taxable if he has performed his employment in the Netherlands. If there is a treaty, as with the UK, then the Netherlands usually has a "formal" employer approach in which the recharging of the remuneration is not decisive. The agency should deduct Dutch wages tax from remuneration from the start of the employment. However, if the UK Employment Agency fails to account for wages tax, the Dutch company will be liable for unpaid tax. In order to protect themselves against this liability, it is common practice for Dutch companies to withhold part of the payments to foreign Employment Agencies until arrangements have been made by the UK Agency to withhold tax on behalf of the employee.

To protect against the legal liability the client can pay part of the fee due to the Employment Agency into a G account. This is a blocked account of the Agency, which can only be used to pay wages tax and social security contributions to the NTA. The amount paid into a G-account cannot be seen as an advance levy. Wages tax is not legally paid until the

Agency uses the G-account to pay taxes to the NTA. De-blocking will not happen automatically and can only take place on special request.

A special form is needed to unblock a G-account. This can be obtained from the Belastingdienst/Centrale administratie, sector betalingsverwerking [previously Centrale betalingsadministratie (Central Payment Administration),] WKA department. The address and fax number are listed at the end of this article. To unblock the account the employment agency will need to demonstrate that the money in the G-account is no longer needed for the payment of the relevant tax due. Each payment to a G-account relates to particular employees and periods. If - for example from a wage tax declaration - it appears that there is no, or less, tax due for those employees and that period, and that there are no other Dutch tax liabilities of the company, then the surplus can be released.

## Agency obligations in the UK

Workers who remain resident in the UK will still be subject to the PAYE system. Paragraph 122 on page 70 of the Employer's Further Guide to PAYE and NICs (CWG2 (2002)) advises employers who are faced with making two lots of deductions from pay to contact their Inland Revenue Office. The Revenue may agree a procedure whereby PAYE can be operated net of credit relief, that is PAYE deductions will take account of overseas tax actually payable on, and deducted from, an employee's wage. This is set out in the Employment Procedures manual at Appendix 5.

It is important to note though that for this procedure even to be considered the tax must be deducted on a monthly or weekly basis in the Netherlands so that it can be matched with the PAYE deductions in the UK.

## Credit in the UK for foreign tax paid

If Netherlands wages tax is correctly due and borne by the worker concerned they will be able to claim credit for this against UK tax due on the same earnings. If the worker pays no wages tax, their earnings have not borne any foreign tax and so when those earnings are taxed in the United Kingdom there is no credit due for foreign tax paid.

If the Agency pays Dutch wages tax on behalf of its workers from the G account without deducting it from them in turn, this cannot be relieved against its own UK corporation tax as it is not a tax on its profits.

## Further information

Further information on the application of the UK/Netherlands double taxation treaty with regard to employment may be obtained from

Susan New  
Revenue Policy International  
Victory House  
30-34 Kingsway  
London  
WC2B 6ES

Telephone: 020 7438 7250  
E-mail: Susan.new@ir.gsi.gov.uk

In the Netherlands

## General

Belastingdienst / Limburg [previously Belastingdienst Particulieren/Ondernemingen-buitenland (Tax Authorities Private/Companies abroad), CIBA/WTP dept., Postbus 2865, 6401 BJ Heerlen, the Netherlands.

For questions on payments telephone:  
0031-45-5779572 or 0031-45-5779558

For questions about the contents of returns or on how to file a return telephone:  
0031-45-5779600

## G account enquiries

Belastingdienst/Centrale administratie, sector Betalingsverwerking [previously Centrale betalingsadministratie (Central Payment Administration)] (CBA), WKA department, Postbus 9048, 7300 GK Apeldoorn, Netherlands.

Telephone: 0031 55 528 10 00

Fax: 0031-55-528 22 57.

We also understand that information , in the English language, on the supply of staff to the Netherlands can be found on: [www.belastingdienst.nl](http://www.belastingdienst.nl). Select "*ondernemers*" on the first page. Then select "*Buitenland*" for international issues.

wider publicity for this strategy, details of Revenue Prosecutions are occasionally published in Tax Bulletin.

## Extra-Statutory Concessions - Between 1 February 2003 and 31 March 2003

No new Extra-Statutory Concessions have been made in this period but the 20 ESCs listed below have been enacted in the Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003). The Act came into force on 6 April 2003.

ESC Number	Subject	ITEPA 2003 Reference
A1	Flat rate allowance for cost of tools and special clothing	Section 367
A2	Meal vouchers	Section 89
A6	Miners: free coal and allowances in lieu	Section 306
A22	Long service awards	Section 323
A24	Foreign social security benefits	Sections 645 and 681
A25	Crown servants engaged overseas	Section 28
A57	Suggestion schemes	Sections 321 and 322
A58	Travelling and subsistence allowance when public transport disrupted	Section 245
A59	Disabled persons' home to work travel	Sections 246 and 247
A62	Pensions to employees disabled at work	Section 644
A65	Workers on offshore oil and gas rigs or platforms: free transfers to or from mainland	Section 305

A66	Payments for employees' journeys home: late night travel and breakdown in car sharing arrangements	Section 248
A70	Small gifts to employees by third parties and staff Christmas parties	Sections 264, 270 and 324
A71	Company cars: family members and shared use	Sections 148 and 169
A72	Pension schemes and accident insurance policies	Section 307
A74	Meals provided for employees	Sections 266 and 317
A84	Allowances paid to detached national experts	Section 304
A85	Transfers of assets by employees and directors to employers and others	Section 326
A91(a)	Living accommodation provided by reason of employment	Section 108
B27	Approved employee share schemes: jointly owned companies	Paragraph 46 of Schedule 3 and Paragraph 34 of Schedule 4

## Statements of Practice - Between 1 February 2003 and 31 March 2003

No new Statements of Practice have been published in this period but the following Statements of Practice have been enacted in ITEPA 2003 with effect from 6 April 2003.

SP Number	Subject	ITEPA 2003 Reference
SP7/79	Benefits in kind: Cheap loans: Advances for expenses	Section 179
SP2/81	Contributions to retirement benefit schemes on termination of employment	Section 408

## CONTENT

The content of Tax Bulletin gives the views of our technical specialists on particular issues. The information published is reported because it may be of interest to tax practitioners. Publication will be six times a year, and include a cumulative index issued on an annual basis.

- You can expect that interpretations of the law contained in the Bulletin will normally be applied in relevant cases, but this is subject to a number of qualifications.
- Particular cases may turn on their own facts, or context, and because every possible situation cannot be covered, there may be circumstances in which the interpretation given here will not apply.
- There may also be circumstances in which the Board would find it necessary to argue for a different interpretation in appeal proceedings.
- The Bulletin does not replace formal Statements of Practice.
- The Board's view of the law may change in the future. Readers will be notified of any changes in future editions.

Nothing in this Bulletin affects a taxpayer's right of appeal on any point.

Letters on any article appearing in Tax Bulletin should be sent to the Editor, Mr Shell Makwana, Room G7, New Wing, Somerset House, Strand, London, WC2R 1LB or e-mail [Shell.Makwana@ir.gsi.gov.uk](mailto:Shell.Makwana@ir.gsi.gov.uk). We are sorry though that neither he nor our contributors will normally be able to enter into correspondence about Tax Bulletin or its contents.

## SUBSCRIPTION

The subscription for 2003 is £22. If you would like to subscribe to Tax Bulletin please send your name and address together with your cheque to Inland Revenue, Finance Division, Barrington Road, Worthing, West Sussex BN12 4XH. Cheques should be crossed and made payable to "Inland Revenue".

If you would like information regarding Tax Bulletin subscription or distribution please contact Mrs Jayne Harler, Room G7, New Wing, Somerset House, Strand, London, WC2R 1LB. Telephone: 020 7438 7842. For more general information regarding Tax Bulletin, please contact Mrs Jayne Harler, Assistant Editor, on 020 7438 7842 or at the address provided above.

## COPYRIGHT

Tax Bulletin is covered by Crown Copyright. There is no objection to firms copying the Bulletin for their own use. Anyone wishing to republish Tax Bulletin or extracts more widely should write for permission to Miss Glenda Bishop, Room G12, New Wing, Somerset House, Strand, London, WC2R 1LB.