Getting perNICkety

Accept HMRC's decision and pay the charge or contest it and pay to go to the First-tier Tribunal? **MEGAN BOURKE** explains how her Class 2 National Insurance contributions dispute was successfully resolved.

Readers of "Twisted kNICkers" (*Taxation*, 21 August 2014, page 10) will already know that I like a good NIC pun. That title described my frustration at a flush of letters from HMRC to some of my clients demanding Class 2 National Insurance contributions on their rental income, in particular after the correspondence regarding my client, Mr X.

As a brief reminder (or synopsis for those who missed the first thrilling instalment of this saga), HMRC's rationale was that Mr X's rental activities constituted "gainful employment". I argued that they did not constitute a business, quoting *Rashid v Garcia* [2003] SSCD 36. At the time of writing, in August, I was three months into the argument and growing weary of dealing with HMRC's letters; these included little relevant technical content to justify their bewildering stance.

The reason for this update, apart from the obvious perk of filling my time while I twiddle my thumbs in the middle of the tax return season, is the response I received to the publication of "Twisted kNICkers".

Other advisers from all over the country told me that they had the same problem and all had come up against the same bullish responses from HMRC. We all agreed: the department was overstepping the mark.

KEY POINTS

- HMRC are seeking payment of Class 2 National Insurance contributions on rental income.
- The department considers that rental activity constitutes "gainful employment".
- Payment of the contributions may be an easy option, but this does not mean that state benefits will be paid automatically.
- Despite arguing that tax and National Insurance are different regimes, tax cases were quoted.
- HMRC decided that they would "not insist" on payment of Class 2 contributions.

Why not just pay?

In his article "More window cleaning" (*Taxation*, 9 October 2014, page 8), Richard Curtis wondered about the ages of my clients and whether it would be better for them to pay the contributions to qualify for the state pension. I could see Richard's point, and I had considered this at the time, but there are two reasons to be wary.

- First, the clients in my case have employment income. Mr X is a director shareholder of a company and is being paid a salary equivalent to the National Insurance primary threshold. This means he already has his "stamp" for the year and the workings set out in Social Security (Contributions) Regulations SI 2001/1004, Reg 21 (annual maxima for those with more than one employment) would prevent the reclaim of Class 2 contributions.
- Second, although I can see that it would be tempting for landlords who have only rental income and are looking for a relatively cheap method of obtaining a National Insurance record to simply pay up, would HMRC keep their end of the bargain? In *Rashid v Garcia*, Mr Rashid had paid Class 2 contributions on his rental income and wanted to claim incapacity benefit. HMRC had been happy to accept the payments, but later changed their mind when he claimed the associated benefits. The department won the case, arguing that Mr Rashid was not "gainfully employed". My concern would be whether a landlord might pay Class 2 contributions, only to be told on retirement that these should not have been paid and therefore they did not have enough years to qualify for a state pension.

The latest update

So, what has happened since my article in August? The next letter from HMRC on the subject of Mr X's National Insurance liability, like its predecessor, promised much in the way of explanations. I was treated to a lesson on how, when individuals

"usually have received monetary gain", this would be seen as "gainful". I am not sure how clear things are when definitions include the word that is to be defined. Next, I was informed of the *Oxford Dictionary* definitions of the words "trade" and "business" and how they refer to the individual being engaged in "an activity".

HMRC explained that they "need to establish the range of activities they undertake when managing their property". Seemingly, they had forgotten the lovely questionnaire I had filled in and sent back several months earlier.

The letter went on to explain that there were two cases they would like to share with me. "The first case (which you are already aware of) is *Rashid v Garcia*." Yes, I was indeed already aware of this case; in fact I had sent *them* a copy with my response to their previous missive. The sum of their analysis of this case, the results of which supported my specific client's position, was that "the case was borderline" and "each is decided on its own merits".

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The second case to be quoted by HMRC was *Elisabeth Moyne Ramsay v CIR* [2013] STC 1764, which involved capital gains tax, namely incorporation relief under TCGA 1992, s 162. Eagle-eyed readers may remember that a lot of the points made by HMRC in their previous letters revolved around how National Insurance and tax were two completely different beasts and could not be compared. I confess that I was amused to then be confronted with a tax case supporting their position. One of their previous comments in respect of the disparity between the tax and National Insurance treatments of income had been: "It must be remembered that there are two different laws." Reader, I may have mentioned this in my response.

The *Ramsay* case

In the *Ramsay* case, the First-tier Tribunal decided that the taxpayer's activities in respect of the properties did not constitute a business. However, an appeal was made to the Upper Tribunal (UT) who overturned the original decision and stated that the property letting should be treated as a business for the purposes of capital gains tax rollover relief. The result in this case was welcomed by many in the tax profession as laying down a marker for others to benefit from the valuable tax treatments and reliefs that can be available to traders. However, it would now appear that HMRC are trying to go some way to turning around this defeat by using it to support their arguments in the world of Class 2 National Insurance.

The letter concluded with the statement that it was HMRC's opinion that they had acted correctly and that Mr X should be classed as self-employed. I was also informed that the case was at the "informal opinion stage" and that if I still disagreed I should tell them why I thought they were wrong, but if we failed to reach agreement I would have to take it to the tribunal.

Appealing to the tribunal

At this point, I would like to include the comments by the ICAEW's David Heaton in the online Tax Forum. The ICAEW had challenged HMRC on this policy earlier in the year to no avail. David said: "Given that a demand for Class 2 will never be for more than £143 a year, and only six years can be enforceable, there's little financial incentive for any affected taxpayer to incur costs fighting the demand before the First-tier Tribunal, which is sad because that's the only way that HMRC could be forced to see the error of its ways."

It seems to me that HMRC, confident that there would be general reluctance to take this to the tribunal because of the cost considerations, feel free to take this dogged position. If this is the case, I find it hugely disappointing. HMRC are cracking down on those taxpayers whom they deem to have undertaken aggressive or artificial tax planning arrangements and we in the tax profession have often been accused of enabling this "egregious" behaviour. In my opinion, HMRC's stance on this point is no different from a taxpayer taking an unrealistic interpretation of the legislation except that the latter would have to pay a penalty and interest.

Readers may not be surprised, given my writing style, that as my frustration grew so did the thinly veiled sarcasm in my replies to HMRC. In fact, I thought it best to ask a colleague to check whether I had gone too far. Because all of my previous arguments had been ignored, my letter pointed out that the usual process for a disagreement is for both sides to set out their view and counter the other's arguments. I detailed all of my arguments before including a bullet point summary of the most salient points – in a neutral fashion. My closing remark was to state that, should HMRC be unable to form a coherent argument supporting their claims, I would be requesting an internal review.

In the meantime, I had started to deal with more of these demands and my experience with Mr X's case led me to include more of these arguments earlier on, in particular referring to the useful *Rashid v Garcia* case. However, I really did expect that I would eventually be told to get the client to pay the contributions or go to the tribunal.

Case conclusion

On a Friday afternoon I received two notices from HMRC. One notice was for Mr X, the other for a client who had been

experiencing the same problem. Both replies started: "I have contacted our technical team to obtain further guidance on your client's case." Here we go again, I thought. The replies continued: "They have advised us to disregard your client's property letting income as self-employed earnings in this case."

It was too early for this to have been my Christmas present from HMRC but, since it was my birthday the next week, perhaps that was what they were aiming for. Or could it just be that someone there reads *Taxation*. Who knows?

A victory this may have been but, as is often the case when dealing with HMRC, it was a hollow one. They had also enclosed a copy of the letters that they had sent to the clients on the matter. I found myself annoyed by the following: "In your particular circumstances we have decided that we will not insist that you pay these Class 2 National Insurance contributions." My colleagues will report that I could be heard repeating "not insist?" in various incredulous tones for quite some time.

Lessons for the future

The moral of this story – or the message that I would like people to take from it – is that I think HMRC will continue to try their luck with this one.

The final responses were very much geared to imply that HMRC were right and they were doing my clients a favour by waiving the supposed National Insurance liability. The word "concession" was used multiple times. This way, they can carry on issuing these notices because they have not admitted to being incorrect.

However, the good news is that from April 2015 Class 2 National Insurance will be collected on the same basis as Class 4. This will mean that no contributions will be collected from rental income, regardless of interpretation, because Class 4 deductions are made on profits from a "trade", which is more narrowly defined. A cynical person may not be surprised that a these demands have been sent out now when there is such a narrow window of opportunity remaining.

> ***"I am particularly concerned about the unrepresented taxpayer and feel that HMRC should hold themselves to a higher standard."***

As previously mentioned, I am particularly concerned about the unrepresented taxpayer in these circumstances and feel that HMRC should hold themselves to a higher standard. Behaviour like this will raise yet more concerns over the awarding of additional powers to HMRC and is another example of why the petition #APowerTooFar garnered so much support. ■

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