SQUIRE SANDERS | LEGAL COUNSEL WORLDWIDE

UNITED KINGDOM TAX BULLETIN

Squire, Sanders & Dempsey

December 2008

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CURRENT RATES — December 2008

Indexation

Retail price index: November 2008	216.0
Inflation rate: November 2008	3%

Indexation factor from March 1982:

to April 1998	1.047
to November 2008	1.719

Interest on Overdue Tax

Income tax/CGT/NIC	5.5%	from	6 December 2008
Inheritance tax	3%	from	6 December 2008
VAT	5.5%	from	6 December 2008
Corporation tax	5.5%	from	6 December 2008
CTSA instalments	3%	from	15 December 2008

Repayment Supplement

Income tax/CGT/NIC	1.5%	from	6 December 2008
Inheritance tax	3%	from	6 December 2008
VAT	2%	from	6 December 2008
Corporation tax	2%	from	6 December 2008
CTSA instalments	1.75%	from	15 December 2008

Official Rate of Interest

From 6 April 2007 6.25%

Residence and Domicile

HMRC have issued another list of Frequently Asked Questions. Many of these questions and answers are entirely straightforward and unremarkable, but the clarification of some points is extremely helpful.

HMRC confirm that a valid alienation of income, even to a relevant person, can be made in 2008/09 and will not be taxable even if remitted to the United Kingdom, providing the relevant income or gains arose prior to 6 April 2008. (This is particularly helpful, as it is contrary to other views that have previously been expressed – for example, in the guidance note issued last month by the Tax Faculty).

HMRC confirm that they are introducing a form on which trustees of nonresident trusts may make a rebasing election. The earliest deadline for trustees to make such an election will be 31 January 2010 – which will apply when a capital payment (i.e., a benefit of any kind) has been made to a UK resident beneficiary in 2008/09.

As far as offshore mortgages are concerned, a number of uncertainties have arisen relating to the transitional provisions for mortgages that existed as of 6 April 2008 and that were used to acquire UK property. Any foreign income used to discharge the mortgage or the interest since 5 April 2008 will be treated as a remittance – unless the grandfathering provisions apply; that is to say the terms of the loan has not been varied, there has been no further advance and the identity of the property has not changed. However, in situations in which a further advance has been made, the advance will not disqualify the whole loan from the benefit of the transitional provisions. The payment of interest on the part of the loan received before 12 March will continue to not be regarded as a remittance.

Dividend Waivers

The recent Special Commissioner's decision in *Buck v HMRC SpC 716* examined whether a dividend waiver represented a settlement for the purposes of income tax.

Mr Buck had 9,999 shares in an unquoted trading company and one share was owned by his wife. Shortly before the year end, Mr Buck waived his dividend entitlement and a dividend was

subsequently paid of £35,000 per share for the year, all of which was paid to his wife. The same occurred in the following year.

HMRC argued that the dividend waivers and the subsequent dividends represented an arrangement for the purposes of Section 660G Taxes Act 1988 (now Section 620 ITTOIA 2005) and, therefore, a settlement within Section 660A TA1988 (now Section 625 ITTOIA 2005). They did not consider that exemption in Section 626 ITTOIA 2005 applied, because the arrangement did not represent an outright gift by one spouse to another of property from which income arises. Also, in any event, the subject matter of the gift was wholly or substantially right to income. The taxpayer claimed that there was no arrangement; it was in the company's interest to pay out maximum dividends, and he had not wanted to receive them.

The Special Commissioners found the HMRC arguments compelling (and who can blame them?), with the result that the whole of the dividend was treated as the income of Mr Buck and taxable on him accordingly.

It seems pretty clear that a dividend waiver can be a settlement – providing, of course, there is an element of bounty. This would seem particularly to apply to a dividend waiver enabling another shareholder to receive an increased dividend. However, this will not always be the case. A dividend waiver is the abandonment of a contingent right so that the relevant shareholder does not receive the dividend. That does not necessarily mean anybody else receives more. It will do so if a dividend is proposed of a fixed monetary amount and one shareholder waives their entitlement; clearly, the whole of the fixed sum will then go to the others and they will receive more than would otherwise have been the case. That would represent bounty, and the settlement provisions would apply. However, if a dividend is proposed of a fixed amount per share, the fact that one shareholder waives his or her entitlement does not increase the amounts payable to the others. In those circumstances, there can be no bounty and no settlement. But you should not be too clever, because (as in the case of Mr Buck) if you propose a dividend per share that is clearly in excess of the company's distributable profits, the whole arrangement will be a settlement. The amount payable to the other shareholders will be possible only because the proposed dividends will obviously have been made in the knowledge that the waiver would be made.

Nobody can take exception to a shareholder receiving a dividend on his or her shares, even if nobody else receives a corresponding dividend. HMRC are likely to get excited only if

arrangements are made whereby a (say) 30-percent shareholder receives more than 30 percent of the distributable profits. In such circumstances, HMRC are likely to cast around for reasons for this discrepancy in an attempt to invoke the settlements law.

The proposals for new provisions on income splitting may have been quietly dropped – but Section 625 ITTOIA 2005 is still a powerful weapon in the hands of HMRC.

Tax Penalties

The recent case of *Wilson v HMRC SpC 724* is extremely brief, but rather alarming. The brevity of the Special Commissioners' judgment clearly permits a degree of misunderstanding, which I hope will be clarified in due course by those who know more about the case.

It would appear that Mr Wilson submitted his tax return for 2004/05, but HMRC lost it and, therefore, failed to open an enquiry into that year within the enquiry window. They wanted a copy of the tax return so they could decide whether there were grounds for issuing an assessment out of time. Accordingly, they issued a notice under Section 20 TMA 1970, requiring him to deliver a copy. He did not do so, and the Special Commissioners imposed the maximum penalty.

It seems quite extraordinary that the taxpayer should be penalised for not retaining a copy of his or her tax return. I was not aware of any requirement for the taxpayer to do so – and if HMRC have lost it, they would seem not to have any grounds for making any assessment at all.

The taxpayer has an obligation under Section 12B TMA 1970 to keep such records "as may be requisite for the purpose of enabling him to make . . . a correct and complete return" and to preserve those records until HMRC no longer has power to make enquiries. That will generally be the end of the enquiry window, or six years for those carrying on a trade. However, this is not at all the same thing as obliging the taxpayer to keep a copy of the return.

If a taxpayer does not keep records or loses his records, HMRC will deny entitlement to allowances or relief on the grounds that it is up to the taxpayer to prove a claim and, if he or she cannot do so, bad luck. Furthermore, if he or she does not have sufficient records to show that an assessment made by HMRC is wrong, he or she has to pay the tax. How can it be right that if HMRC lose the tax return (or anything else, I suppose), they can penalise the taxpayer for not keeping a copy so that he or she can send them another one? This is so unreasonable that I am

sure that there are some additional facts that were not revealed in the decision of the Special Commissioners, and I would dearly like to know what they are.

New Tax Proposals

Santa came early this year in the shape of a press release by HMRC, "Two New Tax Proposals for 2009" – at least I thought so. Unfortunately, when you read the press release, it is rather less exciting than you might expect. The changes relate to the definition of ordinary share capital for determining the existence of a 75-percent subsidiary for group relief purposes, and to the computation of profits in foreign currency.

It is not unusual for preference shares to be issued without a fixed entitlement to dividend, even though they have no votes or any other rights of participation. This will cause them to be regarded as ordinary shares and this interferes significantly with the determination of who should be entitled to group relief – or, alternatively, provides opportunities for group relief to be claimed in an unexpected manner.

In effect from 1 January 2008, it is proposed that preference shares that would qualify as fixed rate preference shares if it were not for the existence of right to pay a lower dividend (or no dividend) in certain defined circumstances will be treated as fixed rate preference shares for group relief purposes. An election will be available to enable the change to apply to new share issues only.

This change seems to relate only to group relief and the definitions within Schedule 18 Taxes Act 1988 and not to the capital gains tax provisions in Section 171 TCGA 1992, whereby assets transferred between members of a 75-percent group are treated as taking place on a no-gain/no-loss basis.

The second proposed amendment is to allow companies to compute their profits or losses in the currency of the territory where the company operates. Fluctuations in exchange rates mean that the requirement for companies to convert the profits or losses of an accounting period into sterling at the average rate for the period can create difficulty. For example, where a loss arises, it must be carried forward in sterling and offset against future profits. However, foreign currency fluctuations may mean that the measure of foreign profits in the future could be different – and the press release quaintly says that both the taxpayer and the Exchequer are exposed to the exchange risk.

Accordingly, it is proposed that any unused losses at the start of accounting periods beginning on or after 1 January 2008 be converted into their functional currency at the start of the period and carried forward in that currency.

Corporation Tax: Small Companies Rate

HMRC have released a letter providing guidance on the new rules for associated companies for the purposes of the small companies rate of corporation tax.

These new rules came into force on 1 April 2008 and were designed to narrow the definition of associated companies. This definition had proved to be unacceptably wide, particularly in the context of film partnerships. All the partners in partnership are associates for the purposes of the associated company definition, and any company controlled by any of the partners in a film partnership would, therefore, be an associated company for the purposes of the small companies rate of corporation tax.

This was not only absurd, but imposed an impossible compliance burden on such partners. Accordingly, Section 35 Finance Act 2008 introduced a general exclusion from the associate rules in relation to rights held by other members of the partnership. However, this exclusion does not apply when there are "relevant tax planning arrangements" in existence that involve the taxpayer and any partner securing a reduction in the company's liability to corporation tax by reason of the small companies rate.

HMRC have confirmed that these changes will apply to periods only after 1 April 2008. Furthermore, they explain that as far as prior periods are concerned, enquiries regarding associated companies will be opened only in cases in which the amount of tax at risk is significant and where there is evidence of associated companies.

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30 December 2008

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Articles and Publications

Peter Vaines: *New Law Journal,* article: December 2008

Peter Vaines: CIOT Tax Conference: Presentation: 3 December 2008

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Published by:

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EC2N 1HQ