UNITED KINGDOM TAX BULLETIN

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January 2009

Inside

Current Rates: The latest rates of inflation and interest

Residence and Domicile: Some more Frequently Asked Questions

High-Net-Worth Individuals: HMRC set up a new unit

Foreign Currency: The exchange rate fluctuations have tax implications too

Capital Gains Tax: The form for the rebasing election is published

Inheritance Tax: The valuation principles are re-examined

Inheritance Tax: The meaning of business property relief is examined

Intestacy: Changes to the statutory legacies come into force

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CURRENT RATES — January 2009

Indexation

Retail price index: December 2008	212.9
Inflation rate: December 2008	0.9%

Indexation factor from March 1982:

to April 1998	1.047
to December 2008	1.680

Interest on Overdue Tax

Income tax/CGT/NIC	3%	from	27 January 2009
Inheritance tax	1%	from	27 January 2009
VAT	3.5%	from	27 January 2009
Corporation tax	3.5%	from	27 January 2009
CTSA instalments	2.5%	from	19 January 2009

Repayment Supplement

Income tax/CGT/NIC	zero	from	27 January 2009
Inheritance tax	1%	from	27 January 2009
VAT	zero	from	27 January 2009
Corporation tax	zero	from	27 January 2009
CTSA instalments	1.25%	from	19 January 2009

Official Rate of Interest

From 6 April 2007	6.25%
From 1 March 2009	4.75%

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Residence and Domicile: FAQs

HMRC have issued another batch of frequently asked questions and answers only a month after the last lot. It is a bit like "University Challenge." We should not complain – this is very helpful material, although it does contain some odd passages including the following:

- A new section on Alienation that does not contain any fresh thinking, but is a helpful and clear confirmation of the position.
- Numerous references throughout the document confirm that the existence of Extra Statutory Concession A11 (split-year treatment) will not operate to reduce the £30,000 charge or affect the new provisions in any way.
- Similarly, there are a number of references to Treaty residence and it is made clear that all years of actual residence in the United Kingdom will count towards the seven-year test even if, in some years, the taxpayer was treated as resident in another country under a double taxation agreement tiebreaker.
- There are some new explanations concerning capital gains tax losses and, in particular, the clogged losses rules in Section 18 TCGA 1992.
- There is a detailed explanation of the rules in Section 809W ITA 2007 relating to the payment of professional fees of UK advisers out of foreign income. This includes a helpful recommendation by HMRC that if there is work undertaken on UK property and on property outside the United Kingdom, if the work can be distinguished and charged separately, it should be. In that way the exemption will apply to the fees for the non-UK property that are paid outside the United Kingdom.

There is a bewildering example about a plumber who comes from Poland to the United Kingdom and becomes resident in September 2008. He has two suits. One was purchased in June 2008 and the other in December 2008 – both out of income from work in Poland. HMRC go to great length to explain why, if on subsequent visits he wears the suit purchased in December, it would be a taxable remittance, but if he wears the suit purchased in June, it would not. I do not see why, because it would surely be excluded by Section 809Z2, being clothing, footwear, jewellery or watches for his personal use. However, even if they are right, you would have thought that HMRC would have been too embarrassed to publish something so absurd and would conclude (rightly) that it would bring them into disrepute. However, I fear that the Treasury has lost all touch with reality.

Let us look at this some more. A remittance includes enjoying foreign income in the United Kingdom, e.g., bringing an asset to the United Kingdom that had been purchased out of foreign income. The income is taxable only if it arose at a time when the individual was UK resident. (That is why the suit purchased in December, by which time the plumber had become resident, was taxable). However, a moment's thought reveals the absurdity here. Most UK-resident non-doms spend a good deal of time outside the United Kingdom and will no doubt spend their foreign income in their home country or elsewhere. When they come to the United Kingdom, will they have to ensure that their luggage contains no items that have been purchased abroad apart from clothing, footwear, jewellery or watches? Woe betide them if they had some dental work or hair extensions (whatever they are) done whilst they were abroad! – and what about their mobile, or camera?

Maybe there will be a big new sign at the airport: "Did you buy your children's socks with your foreign income? Please go through the new Arrivals channel, where you can examine all these FAQs." I wonder what colour this channel would be. Puce sounds appropriate, so that it would not clash with the faces of the passengers.

It gets worse. HMRC pose the question:

"If someone purchases an aeroplane ticket in New York for a flight from JFK to Heathrow, does the fact that the plane lands here mean that the entirety of the service is deemed to be provided in the UK and therefore if the plane ticket is purchased out of relevant foreign income it is deemed to be remitted?".

HMRC say yes. The service was provided in the United Kingdom because the plane lands here. But what if the flight was from JFK to Frankfurt (or from Dublin to Paris) and did not land in the United Kingdom? It would necessarily pass through UK airspace (which HMRC confirms is part of the United Kingdom), so that must be a remittance too. There are no "in transit" rules that apply here. Let us hope that HMRC agree that this is bonkers and decide to reconsider their interpretation.

High-Net-Worth Unit

Newspaper reports have appeared about a suggestion that HMRC are establishing a special unit to take responsibility for high-net-worth individuals. The implication is that those with significant assets will be specifically targeted in the hope of increased tax collection. It is difficult to think of anything that is likely to be more damaging to wealth creation in the United Kingdom – and the creation of jobs – for which I understand there is a particular need just at the moment. Well, perhaps there is something. They could impose a special charge on foreign-domiciled people who come here bringing their wealth to create businesses and jobs in the United Kingdom. HMRC could target them and charge them lots of tax so they either leave or don't come in the first place. No. Of course not. That would be a silly idea.

Anyway, this new initiative seems to have derived from the minutes of the Complex Personal Tax Return Team Consultation Forum that were published recently. (Um. Somebody must have told me about them. I cannot admit to being such a saddo as to read these things myself). Actually, this sounds like a good idea; a special unit of experienced inspectors dealing with complex tax returns should be good for everybody. It is likely that the relevant skills on many of the issues arising in complex cases will be more readily to hand, as they would be closer to teams with expertise on trusts, inheritance tax and so on. It may avoid a lot of misunderstandings born of inexperience.

However, these are the very claims that are already made for the Complex Personal Return Teams so why do they need a new unit? It is no surprise that considerable disquiet has been caused by the publication of this idea, but let us hope that it proves to be a good and helpful move.

Foreign Currency Gains

The dramatic change in the value of the euro has all manner of implications – including tax. It should be remembered that foreign currency other than sterling is a chargeable asset for capital gains tax purposes under Section 21 TCGA 1992, so a charge to capital gains tax could inadvertently arise.

For example, a non-dom could have carefully arranged to maintain capital and income accounts outside the United Kingdom, ensuring that the capital account contains only principal and all income is paid directly to another account. Remittances are made only from the capital account, which are not, of course, chargeable to tax in the United Kingdom. Well, *maybe* not chargeable. If the capital account is in euros, a transfer to the United Kingdom and conversion to sterling could well give rise to a significant capital gain that would be immediately taxable.

The position could be worse with a foreign property. A property purchased in Europe for €500,000 (and with a €500,000 mortgage) may have been acquired when the euro was at £1.50. If the property is now sold for the same price, and the mortgage discharged, at a time when the euro is standing at £1.10, the sterling equivalent of the sale price would give rise to a profit of £121,000. The mortgage will be £121,000 more as well, so in net terms, everything balances. Unfortunately, however, the gain on the property is chargeable to capital gains tax, whereas the loss on the mortgage is not an allowable loss. Losses arise only on the disposal of assets, and a liability (even in euros) is not an asset.

It would not matter whether the sale proceeds were ever converted into sterling; it is the disposal of the property that represents the chargeable disposal for capital gains tax on which the gain will arise. To make matters worse, if there is a delay between selling the property and discharging the mortgage and the euro strengthens during that period, a further gain might arise. For example, the property might be sold when the euro is standing at £1.10 and the sale proceeds are £454,500. If the proceeds are placed on deposit and the euro strengthens to parity with the pound before the mortgage is paid off, the disposal of the euros in discharge of the mortgage will give rise to an exchange gain of £46,000. Similarly, with the cruellest of ironies, if any of the euros are used to pay the capital gains tax, that would also give rise to a disposal of the euros and this could rise to a further charge to capital gains tax.

Non-doms who are subject to the remittance basis will need to bear this point in mind in deciding whether to pay the £30,000 non-dom charge. Although the gain arising outside the United Kingdom would be taxable only if remitted, it cannot be overlooked in the calculation.

Capital Gains Tax: Rebasing Election

HMRC have now published the form for the rebasing election. Some fears had been expressed that HMRC would require a disproportionate amount of information to enable rebasing to be claimed – but this has proved not to be the case. The form merely requests the name and date of the settlement, the name and address of the trustees and the date of the capital payment that is the trigger for the rebasing election.

The purpose of the election is to ensure that foreign-domiciled beneficiaries who receive capital payments will not be taxed on the amount of the gains up to 6 April 2008 made by the trustees or by an underlying company.

The election causes the gain on the disposal of an asset by the trust (or underlying company) to be divided between pre- and post-5 April 2008 elements. The gain up to 5 April 2008 will not be chargeable to tax on a foreign-domiciled beneficiary. However, the election will have no effect on UK-resident and domiciled beneficiaries, who can continue to have the full amount of the gain attributed to them by reference to capital payments in the normal way.

Inheritance Tax: Valuation Issues

It may be remembered from the August 2008 *Tax Bulletin* that in the case of *Bower deceased v HMRC SpC 665,* the Special Commissioner came up with a novel basis of valuation being the price that a willing speculator would be prepared to pay for the relevant asset.

The High Court has concluded that the Special Commissioner's decision was wrong. The full judgment in this case will apparently not be available for some time (citation: [2009] ALL ER (D) 68), so anybody particularly interested in this area will need to be patient, because the case digest does not really say very much.

The asset in question was the right to a life annuity under a discounted gift bond – not an easy thing to value at the best of times. The following principles, which seem to be uncontroversial, emerged from the digest. The property should be assumed to have been capable of sale in the open market – even if it was inherently unassignable or subject to restrictions on sale. The question was what a purchaser in the open market would have paid to enjoy whatever rights attached to the property at the relevant date.

The judge thought that the Special Commissioner might not have appreciated that the hypothetical sale took place in the real world. Although there had to be an assumed buyer in order to give effect to the statutory hypothesis that the sale took place and although the Special Commissioner had been entitled to consider possible purchasers, he was not entitled to invent them. The High Court made reference to the introduction of a speculator into the process, but there is no indication of how such a speculator should be viewed. (I find it very difficult to understand how a speculator can be brought into the mix at all, because it is well established that the hypothetical buyer is supposed to be a prudent purchaser who is also a prudent businessperson. It will be interesting to see more about this).

The High Court observed that the Special Commissioner's method of calculation had not been put forward by either of the parties, nor any of the witnesses. This was considered to be a breach of natural justice, and it was certainly not based on the evidence before him. It had flowed from his erroneous conclusion that he had been required or entitled to populate the real market in which the hypothetical sale took place with hypothetical speculators who had not shared the characteristics of real buyers.

I think that, mercifully, we are back to normal as far as inheritance tax valuation principles are concerned.

However, there is one point of which it will be very interesting to obtain further details. This is his Lordship's suggestion that "if in the real world an asset was worthless, the statutory hypothesis did not make it valuable". I would suggest that the very existence of a statutory hypothesis that excludes devaluing factors, such as the inability to assign or restrictions on sale, means that this is exactly the position. It requires an asset to have a value placed on it that does not exist in the real world by ignoring devaluing factors. Indeed, the judge even acknowledges the point by saying that the property should be assumed to have been capable of sale in the open market even if, in fact, it was not.

Having regard to the subject matter of this case, which was an AXA Estate Planning Bond for which the tax advantage was derived from the amount of the discount (and as a result of this case, the discount is negligible), one might expect the case to go further.

Inheritance Tax: Business Property Relief

I must admit my surprise to find that the Revenue have lost their appeal in the case of *HMRC v Nelson Dance Family Settlement* [2009] EWHC 71. This really is a case of the textbooks having to be rewritten. The taxpayer had a farm and transferred some of the farmland to a trust claiming 100-percent business property relief. The land was used in the farming business, but Mr Dance did not transfer business or an interest in the business to the trustees; he transferred just the land. HMRC said that business property relief was not available – it was necessary for him to transfer a business or an interest in the business to qualify for the relief.

It seems generally to have been accepted that relief is not available on a simple transfer of an asset used in a business. Business property relief derives from Section 104(1) IHTA 1994, which says that the relief applies:

> *"Where the whole or part of the value transferred by a transfer of value is attributable to the value of any relevant business property"*.

Relevant business property means "property consisting of a business or interest in a business".

It was, therefore, generally understood that unless you transfer relevant business property, you do not qualify for the relief. The land transferred by Mr Dance was not itself a business or an interest in the business; it was, therefore, not relevant business property, so HMRC said that the relief was not available.

The Special Commissioners said that this was not the correct reasoning, and their view has been upheld by the High Court.

We have been looking at the wrong question. The question is not whether the land itself is relevant business property, but whether the value transferred is attributable to the value of any relevant business property. The value transferred was not the value of the land but the diminution in the transferor's estate by reason of the transfer. So, you do not look at the subject matter of the gift, but at the amount by which the transferor's estate is diminished, and see whether that amount of value is attributable to the value of the assets used in the business. On this basis, the transfer of the land to the trust qualified for business property relief.

(This is not an easy analysis, but you can see how the argument runs. However, I found it a bit much for His Lordship to say that the taxpayer's argument *"has the very considerable merit in a taxing statute of simplicity and certainty. [On this interpretation] citizens can know clearly when the tax may be charged and BPR is to be available and can plan their affairs accordingly"*. The position is so clear that the distinguished and learned authors of the three major textbooks on the subject all got it wrong.)

This does open up a number of significant planning opportunities, because any asset of the business can be given away with full business property relief, such as the odd farm building or various fields – and even cash. If the business has significant amounts of cash (required for a genuine business purpose and not an excepted asset) simply transferring the cash to a discretionary trust would clearly be eligible for business property relief. However, I do not think that I would rush to do so until such time as the appeal position has been clarified.

Intestacy

On 1 February 2009 the amount of the statutory legacies payable to the surviving spouse on an intestacy is being increased from £125,000 to £250,000 (where there is issue) and from £200,000 to £450,000 (where there is no issue).

It is understood that the majority of the population do not have a will and there may be many reasons for this. They may feel that their estate is too small to warrant the trouble and expense of a will, or they may assume that by their doing nothing, the surviving spouse will automatically inherit everything. This is possible, but generally only when there are no children or other issue, no parents, no brothers or sisters, or nieces or nephews – hardly very likely.

The reasonably well informed will be aware that there are statutory provisions dealing with the devolution of property on an intestacy. However, they may not appreciate just how these rules work or where their money may end up – or the tax implications.

An important consideration is that getting married (or entering into a civil partnership) automatically revokes a will unless it is made specifically in contemplation of marriage. Accordingly, newlyweds could find themselves without valid wills just at the time when having a will is of particular importance. The position could be catastrophic. For example, a young (rich) husband and his younger (and less rich) wife may both be involved in a fatal accident on their honeymoon. Unless it can be shown that the wife died before the husband, his wealth will pass to her and almost immediately will pass to her parents. A tragic accident could, therefore, cause the groom’s wealth to pass straight to his mother-in-law. This is not necessarily a prospect he may have fully appreciated in his post- (or pre)nuptial bliss.

I have prepared a guidance note to explain what happens if you fail (or choose not) to make a will and what might be done about it. A copy is available on request.

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27 January 2009

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UNITED KINGDOM TAX BULLETIN

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Articles and Publications – January 2009

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Peter Vaines: *Taxline* Article: January 2009

Peter Vaines: *New Law Journal* Article: 16 January 2009

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Published by:

Squire, Sanders & Dempsey
Tower 42, 25th Floor
25 Old Broad Street
London
EC2N 1HQ

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January 2009

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