SQUIRE SANDERS | LEGAL COUNSEL WORLDWIDE

# UNITED KINGDOM TAX BULLETIN

Squire, Sanders & Dempsey

**February 2009**

**Inside**

SQUIRE SANDERS | LEGAL COUNSEL WORLDWIDE

# UNITED KINGDOM TAX BULLETIN

## CURRENT RATES

**February 2009**

### Indexation

| | |
|---|---|
| Retail price index: January 2009 | 210.1 |
| Inflation rate: January 2009 | 0.1% |

Indexation factor from March 1982:

| | |
|---|---|
| to April 1998 | 1.047 |
| to January 2009 | 1.645 |

### 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% | from | 16 February 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 | 0.75% | from | 16 February 2009 |

### Official Rate of Interest

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

## The Budget: 22 April

The Chancellor of the Exchequer will deliver his Budget speech on Wednesday, 22 April. Opinions are divided about the significance of the date. However, as Parliament goes into recess for Easter on 3 April, this is the first date in April when the Budget would be possible.

Our usual nocturnal activities will take place, and a summary of the Budget proposals will be issued overnight. A breakfast briefing is proposed for 23 April, and further details will be forthcoming shortly.

## Remittance Basis: Nomination of Income

This is an extremely complex issue and creates a real trap for those wishing to claim with the remittance basis. One of the conditions for claiming the remittance basis is that you must nominate part of your foreign income or capital gains for the year. There is no UK tax advantage in doing so, but it can provide an opportunity to claim relief for the £30,000 non-dom charge against the tax liabilities in another country where that income may also be chargeable to tax.

The trap to which this gives rise relates to the rules governing the remittance of monies from mixed funds. Before 5 April 2008 a remittance from a mixed fund was treated as being made first out of income, but now there is a statutory order of priority for a remittance of income or gains from a mixed fund. Perhaps unsurprisingly, the statutory order is the least beneficial order for the taxpayer. If you ever remit any amount of the nominated income, this will cause all the overseas income and gains, nominated or not and whether or not they are in a mixed fund, to be aggregated and treated as if they are all in a mixed fund, subject to the statutory order of priority for that year and all subsequent years. This would seriously interfere with any arrangements for remitting funds to the United Kingdom.

To avoid these difficulties, no remittances should ever be made from the income that has been nominated. If this would be inconvenient, it would be worthwhile establishing a new account with a nominal sum of, say, £1,000, which will give rise to a small amount of income each year. This income would be nominated (it is not necessary to nominate £30,000 of income – any amount will do), and you would know that nothing would ever be remitted from this account, so all the above disadvantages would never arise.

I would emphasise that this is an entirely different issue from the suggestion sometime made that a separate account should be established for the purpose of remitting the £30,000 non-dom charge.

It is possible for the £30,000 charge to be paid out of income earned outside the United Kingdom without the payment giving rise to a taxable remittance. It is necessary for the cheque or transfer to be made directly from the foreign account to the account of HMRC; if the payment is routed through a UK bank account, the exemption will not apply and the payment will represent a remittance. Some people have suggested that, as this will give HMRC details of the foreign account, it would be better to establish a new account specifically for this purpose, into which funds are transferred prior to payment of the charge and which contains no other funds at all. Obviously this is an entirely different point, and it could be catastrophic for the two issues to be confused.

## HMRC Clearances

In April 2008 HMRC announced that they would provide businesses with their view of the tax implications of significant commercial issues regardless of when the legislation was first enacted. On 1 May 2008 this clearance concession was extended to IHT Business Property Relief in situations where the issues are commercially significant. HMRC have now announced that the IHT Business Property Relief clearance will continue. It will also be extended to transfers of value that involve a change of ownership of a business in situations in which, leaving aside the application of business property relief, an immediate inheritance tax charge would arise.

To take advantage of this extremely valuable service, it is necessary for taxpayers to demonstrate the commercial significance of the transaction that causes the uncertainty and to identify which aspect of the law or practice they consider to be uncertain.

It has been revealed by the Chartered Institute of Taxation that in discussions on this topic HMRC emphasised that they had a duty to collect the correct amount of tax and the taxpayer might still be required to pay the tax even though he or she had acted on the clearance from HMRC. There seems little point in seeking a clearance unless it can be relied on, and this is obviously a very hot topic at the present time.

However, the Revenue website does contain an assurance that if the taxpayer has reasonably relied on the advice from HMRC, having made full disclosure of all the relevant facts, and the application of the law would result in financial detriment, then HMRC will consider itself bound by their advice.

This does give rise to a strange conundrum that if HMRC say that they cannot be bound by their statements and have a legal duty to collect the tax, then their assurance that they would be bound in these circumstances would not be binding either.

It is high time that this issue was clarified.

## Trustee Residence

HMRC have published draft guidance on the application of the new residence test for trustees, which was introduced on 6 April 2007. The residence rules for income tax and capital gains tax were harmonised, but the position is far from simple.

A trust will be UK resident if all the trustees are UK resident, and it will be nonresident if all the trustees are nonresident. No problem there. The complications come when some of the trustees are UK resident and some are not. In that case, the residence of the trust will depend on the residence and domicile of the settlor at the time any property is introduced to the trust. If the settlor is not resident, not ordinarily resident and not domiciled in the United Kingdom, the existence of one nonresident trustee will be enough to make the trust nonresident. If, however, the settlor is UK resident or ordinarily resident or UK domiciled, one UK resident trustee will be enough to make the trust resident.

The guidance concentrates heavily on the terms of Section 69(2D) TCGA 1992, which provides that a trustee will be treated as UK resident if he or she acts as a trustee in the course of a business carried on by a branch, agency or permanent establishment in the United Kingdom.

HMRC take the view that a trustee is carrying on business in the United Kingdom if he or she is in the business of providing professional trustee services in the United Kingdom for a fee. This does not necessarily relate to the business of a particular trust that might be conducted by the trustee. “Carrying on business” in this context means activities that are the core activities of a trustee and not those that are preparatory, and HMRC will look at where the core activities are physically carried out. If there is evidence of considerable administrative work, such as meetings with investment managers or beneficiaries, being carried on in the United Kingdom through a permanent establishment, the trustee is obviously in trouble.

The guidance note includes numerous examples that are helpful, but they are likely to be a real headache to foreign trust companies having any kind of presence in the United Kingdom – or, perhaps, are owned by a UK parent.

I cannot imagine that any trustee company in its right mind is going to risk the complete destruction of its professional relationship with its clients by inadvertently finding itself resident in the United Kingdom, so it will make sure that it has nothing to do with the United Kingdom at all. All the business that might otherwise have been undertaken in the United Kingdom – creating jobs, etc. – will be lost. This will be a welcome boost to the offshore centres. The Treasury probably want to make up for being so horrid to them lately.

## IHT: Agricultural Relief

The European Commission has formally requested the United Kingdom to amend its legislation in respect of agricultural property and woodlands because, they say, it is discriminatory, being applicable only to property in the United Kingdom.

The European Commission says that the United Kingdom should allow inheritance tax relief for all agricultural and forestry property situated in the European Union and European Economic Area member states, and is insisting that we change the law to do so. I wonder what happens if we don't.

HMRC have issued some interim guidance in the form of a replacement of the relevant parts of the Inheritance Tax Manual. This is an enormous amount of text, and the changes are not highlighted, so it is extremely time-consuming to identify precisely how their guidance has changed. However, it looks as if the main revision is to exclude almost every reference to the United Kingdom from the passages relating to agricultural relief and woodlands.

## Taxpayers Charter

HMRC are proposing to issue a new taxpayers charter. It is a bit brief – barely representing more than bullet points. The bullet points do not even contain proper sentences – but maybe this will be changed in the final version. A taxpayers charter may be thought of as having little value to the relationship between HMRC and the taxpayer, and can be dismissed on those grounds. However, there is one point that does have a real value and was contained in the first taxpayers charter issued in 1986. That was a perfectly good document, which is equally valid today, and it's a mystery why it was ever withdrawn. It contained a comforting passage that the staff of HMRC will at all times carry out their duties courteously, considerately and promptly. That might have been thought to be self-evident – but it was a fine thing to say, and I wonder why they do not continue to do so.

There was an express presumption of honesty on behalf of the taxpayer, and a new version is introduced into the latest proposed charter, as follows:

> *You can expect HMRC to treat you as honest, believing you are willing to pay what you owe, claiming only what you are entitled to, unless we have good reason to doubt you.*

This is more helpful than it may seem. It is not unusual for HMRC to make enquiries that can be justified only on the grounds that the taxpayer has not told them the truth. To be able to challenge such enquiries, by asking them to provide details of the good reason they must have to doubt what the client has said, could be extremely helpful.

I cannot eke much more out of the proposed charter, and we can only regret that HMRC no longer regard it as important to say that they will be courteous and will have regard to the compliance costs of different taxpayers. One of the most helpful aspects of the original charter was that taxpayers could expect the Revenue to help them in every reasonable way to obtain their rights and to understand and meet their obligations under the tax laws. Maybe that always was taking their obligations a bit far – but it was very nice while it lasted.

## Foreign Dividends

Draft legislation has been published, intended to form part of the Finance Bill 2009, to provide a tax credit to individuals who receive dividends from companies outside the United Kingdom in which they own a minimum of 10 percent in the company. This provision is intended to complement the introduction last year of tax credits to individuals who receive dividends from non-UK-resident companies (not offshore funds) who own less than 10 percent of the shares in the distributed company.

## Valuation of Goodwill

HMRC have published a practice note explaining their new views on the valuation of goodwill in connection with trade-related properties. It goes on for 13 pages, and the essence of the note is to say that they intend to attribute a greater value to the property element in a business sale than has previously been the case. They say that when a business is sold as a going concern, the sale price will reflect the combined value of the tangible assets together with the benefit of other business assets (i.e., goodwill). Substantial value can be realised by combining the tangible and intangible assets, and they conclude that in the past an inadequate amount of value has been attributed to the property assets.

It seems entirely right for HMRC to say that for tax purposes it is necessary to recognise the contribution that each asset makes to the combined value – but there seems to be something not quite right about their analysis.

It starts with the proposition that property-trade-related businesses are rarely, if ever, transferred without any form of property rights. Of course this is circular. A trade-related property will naturally be one that is sold together with the business, and a property related to a business that would not normally be sold with the business would not be a trade-related property. Circular definitions do not achieve anything – except, in this case, it reveals that HMRC are wanting to identify a class of assets being trade-related properties and to make a special case for their valuation.

The implication is that a property from which a successful business trades has some goodwill of its own – but this surely must be a misunderstanding. The goodwill value attaches to the business, and the property value attaches to the property. The fact that some businesses are conducted from properties in key locations does not create goodwill in the property. The value of the property is determined by a number of elements, and everybody knows that the first three most important elements are location, location and location.

If a business succeeds at a particular location, all that means is that there is a successful business carried on from this property. The property is valuable (but the property is valuable anyway), and the owners of the business have been able to run a successful business. The property does not grow in value by reason of the success of the business. Conversely, a valuable property is still a valuable property, even if the business does not succeed.

Another area of confusion derives from the proposition that you find a home for any difference in sale price over the underlying valuations. For example, a business might be sold for £100. The property may be valued at £35, the chattels valued at £10 and goodwill valued at £45. There is a £10 difference, which has to be attributed somewhere.

However, in reality there is no difference. It is just that you have got your values wrong. It could be that the property has been undervalued – and if it has, the value needs to be corrected. This would be unusual, because there is an extensive database relating to the real values of property. (Just at the moment it may be impossible to value anything – but you cannot draw principles from chaos.) In normal times, property values will be pretty accurately determined by those experienced in the field having regard to the characteristics of the particular property and the prices prevailing in that area at that time. If it is a public house or a cinema located in a particular place where a profitable trade might be expected to be generated, that is a function of its location and will be reflected in the property value. Goodwill, on the other hand, is notoriously difficult to value, because it is so subjective and no matter how many calculations you can do, somebody will come along and either pay more or less. However scientific your calculations, they will be wrong.

So, in the above example, assuming the property value is accurate, it is simply the case that the goodwill has been undervalued, because, although the valuer might have thought it was worth £45, it is obviously worth £55. It is not a question of wondering where to attribute the difference. It is a question of putting the figures right.

The flaw in the overall reasoning is to suggest that some part of the profitability of the business should be attributed to the property; however, this is no more correct that saying the business is more valuable than it merits by excluding part of the property value and attributing to the business – for example, the location.

I note from the press release that discussions are continuing with professional bodies on this issue, and I daresay we will receive further information in due course.

**P S Vaines**
**Squire, Sanders & Dempsey**
**27 February 2009**

SQUIRE SANDERS | LEGAL COUNSEL WORLDWIDE

# UNITED KINGDOM TAX BULLETIN


**Contact:**

**Peter Vaines**

London

+44.20.7189.8191

pvaines@ssd.com


## Articles and Publications – February 2009

Peter Vaines: *New Law Journal* Article: February 2009

## Subscription Information

Squire Sanders publishes on a number of other topics. To see a list of options and to sign up for a mailing, or to correct or update information, visit our subscription page.




Published by:

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




**NORTH AMERICA**
Cincinnati
Cleveland
Columbus
Houston
Los Angeles
Miami
New York
Palo Alto
Phoenix
San Francisco
Tallahassee
Tampa
Tysons Corner
Washington DC
West Palm Beach

**LATIN AMERICA**
Bogotá[+]
Buenos Aires[+]
Caracas
La Paz[+]
Lima[+]
Panamá[+]
Rio de Janeiro
Santiago[+]
Santo Domingo
São Paulo

**EUROPE**
Bratislava
Brussels
Bucharest[+]
Budapest
Dublin[+]
Frankfurt
Kyiv
London
Moscow
Prague
Warsaw

**ASIA**
Beijing
Hong Kong
Shanghai
Tokyo

[+]Independent network firm

www.ssd.com