SQUIRE SANDERS | LEGAL COUNSEL WORLDWIDE

UNITED KINGDOM TAX BULLETIN

Squire, Sanders & Dempsey

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Inside

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CURRENT RATES — April 2009

Indexation

Retail price index: March 2009	211.3
Inflation rate: March 2009	zero

Indexation factor from March 1982:

to April 1998	1.047
to March 2009	1.660

Interest on Overdue Tax

Income tax/CGT/NIC	2.5%	from	24 March 2009
Inheritance tax	zero	from	24 March 2009
VAT	2%	from	24 March 2009
Corporation tax	2.5%	from	24 March 2009
CTSA instalments	1.5%	from	16 March 2009

Repayment Supplement

Income tax/CGT/NIC	zero	from	27 January 2009
Inheritance tax	zero	from	24 March 2009
VAT	zero	from	27 January 2009
Corporation tax	zero	from	27 January 2009
CTSA instalments	0.25%	from	16 March 2009

Official Rate of Interest

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

Ordinary Residence

Cases on ordinary residence are extremely rare, so it was interesting to read the decision in *Genovese v HMRC SpC 741,* in which the very point was examined by the Special Commissioners. The taxpayer was an investment banker who came to work in the United Kingdom in 1998. He did not intend to stay, but he did so, and in 2001/02 he decided to buy a property, because house prices in London had increased by nearly 50 percent since his arrival.

The point in issue was whether, by 5 April 2002, he had become ordinarily resident in the United Kingdom. If he was ordinarily resident, he would be liable for tax on his worldwide earnings, whereas if he was not ordinarily resident, he would be taxable here only on the earnings attributable to his work in the United Kingdom.

There is no statutory or other definition of ordinary residence, but the generally accepted test is that the person must be habitually and normally resident in the United Kingdom, apart from temporary or occasional absences. The key word here is "habitually", which consists of two features: being resident here voluntarily, and being resident for a settled purpose. It is sometimes also described as the way in which a man's life is usually ordered. There is no requirement that the United Kingdom be the "real home" of the taxpayer – this is said to be wholly inconsistent with the natural and ordinary meaning of the words.

An important consideration is that ordinary residence is determined by reference to the objective examination of past events – not by reference to intentions or expectations for the future. This is significant because the whole of the arguments of HMRC (reflected in IR20) were that the intention is pretty much all that matters. Interestingly, this idea is repeated in the new residence guidance in HMRC 6 (see the next article) – and it is equally wrong there. (Having regard to the adverse comments made by the Special Commissioner in this case regarding the terms of IR20, it is to be hoped that the revised IR20 will be further revised to reflect a more accurate position.)

As far as Mr Genovese was concerned, the Special Commissioner decided that a period of three years in the United Kingdom was necessary, for his residence here was sufficiently habitual to make him ordinarily resident. In September 1998 he had taken a one-year tenancy of a flat in London with his wife and family, and, accordingly, the Special Commissioner considered that he

had become ordinarily resident in September 2001. This was in the year 2001/02, and it is suggested that he should, therefore, be regarded as ordinarily resident for the whole of that year.

There seems to be inadequate legal authority for much of this, and, rather than this case clarifying the position, we are now in a state of uncertainty about the strict legal position, as well as the HMRC practice (see further below).

IR20: Revised Guidance

The long-awaited replacement for IR20 has now been received. It is called HMRC 6. It is quite similar to IR20, except that it has all been rearranged, which makes it rather difficult to compare. The main elements are still there, although they are now hedged around with so many disclaimers that they begin to look like a Letter of Engagement. The idea that anybody should be able to rely on this revised guidance seems absolutely unthinkable – except that this is surely the only reason it has been published.

Leaving the United Kingdom: Hotel California

It is surprising that, having regard to the critical importance that HMRC place on the concept of a distinct break in all the recent cases on the subject, there is no reference to it anywhere in HMRC 6.

They are very keen on emphasising that the act of leaving the United Kingdom does not mean you will automatically become non resident. After you leave the country, your residence position will be affected by a number of factors, which include:

a) The reason you left the United Kingdom;
b) What visits you make to the United Kingdom after you have left; and
c) What connections you keep in the United Kingdom such as family, property, business and social connections.

This sounds rather as if they are thinking about a distinct break here – but maybe just keeping their options open.

One or two new passages are interesting. For example, in explaining the day count, they say that "it is the number of days counted in this way [i.e. midnights] that is important, not the number of

visits you make to the UK". That is a very helpful statement, but if it is not important, why is the number of visits you make to the United Kingdom a specific question on the tax return?

The whole thrust of their arguments in this most controversial area is that to become non resident you have to leave the United Kingdom. Now, it seems, on their new practice, you have to do more than leave the United Kingdom; you have to leave the United Kingdom and satisfy a number of other conditions as well. It sounds like "Hotel California" to me.

There is also an additional condition if somebody leaves the United Kingdom to work abroad as an employee. We are familiar with the idea that it is necessary to leave the United Kingdom to work abroad under contract of employment that lasts for at least a whole tax year and that you must be absent for a whole tax year, subject to the conventional day counts. However, there is a new condition, which is that "You have actually physically left the UK to begin your employment abroad and not for example to have a holiday until you begin your employment." If you do not meet this condition, you will remain UK resident.

It seems likely that this will catch nearly everybody who goes to take up an employment abroad. Nobody leaves the United Kingdom and arrives in the new country where he or she will be working and immediately goes into the office. People normally have a few days to settle into their new accommodation and start work, perhaps, the following week. Disaster. However, perhaps HMRC will not regard this as having a holiday – but I do not see why not. How many days not working prior to taking up your employment will represent a holiday?

Ordinary Residence

As far as ordinary residence is concerned, there is a whole new section that was not found in IR20. It has no basis in law, of course; it is only their practice – but it is a pity that it is plainly wrong in law, because it concentrates heavily on the intentions of the taxpayer, which are specifically not a relevant consideration.

HMRC suggest that three years is a reasonable period after which it is sensible to regard somebody as ordinarily resident in the United Kingdom. Although there is only doubtful authority for a three-year period, it is a reasonable test with which we have all become familiar and it should not cause any problems. It also found favour with the Special Commissioners in *Genovese.*

However, there is one sneaky change. In IR20, paragraph 3.9 said that you become ordinarily resident from the beginning of the tax year after the third anniversary of your arrival. However, in HMRC 6, they say that you become ordinarily resident at the beginning of the tax year in which the third anniversary falls. This harks back to a change they tried to introduce in the 1992 edition of IR20, but which was subsequently withdrawn. I guess it will stick this time.

Domicile

The domicile guidance is a very good summary, but it is simply not fit for its express purpose. It is supposed to be guidance so that the taxpayer can determine his or her domicile for the purpose of self-assessment. In many quite ordinary situations, the taxpayer would have to be seriously knowledgeable about the subject to reach the right conclusion from this guidance.

There are a few odd passages. For example, they say at paragraph 48130 that "residence creates a presumption of domicile". This must surely be misleading. Of course, you need to be resident to acquire a domicile of choice, but there is no legal presumption about it – and I would suggest there is no presumption at all. You only have to look at *Ramsey v Liverpool Royal Infirmary,* in which it says that "mere length of residence is by itself insufficient evidence from which to infer the animus".

HMRC make it clear that there are many things that go to make up the determination of where a person is domiciled and the sort of enquiries they envisage will, in some cases, be entirely reasonable. However, this does set the scene for an unlimited amount of personal questioning, and HMRC can claim that any question – no matter how irrelevant or intrusive – can be asked with full justification. This could be supported by *Drevon v Drevon* and the celebrated passage that starts "there is no act or circumstance in a man's life however trivial it may be in itself, which ought to be left out of consideration", which means that HMRC can go on asking intrusive questions until the cows come home. Just in case this sounds a little extreme, would you be able to prove that your client's grandparents were validly married under English law, and that one of them was not already married to somebody else (which would make their marriage bigamous and therefore void), causing your client's father to be born out of wedlock, with the consequent effect on his domicile?

It is hoped that HMRC 6 and the accompanying documents are still works in progress and that there is scope for further amendment.

Remittances

The Polish plumbers are saved. It may be remembered from the January *Bulletin* that Polish plumbers have a real problem if they come to the United Kingdom wearing a suit that has been purchased out of their foreign earnings whilst they were UK resident. This would represent the enjoyment in the United Kingdom (i.e., a remittance) of an asset purchased out of foreign earnings and would create an immediate charge to tax on that remittance.

There is an exemption provided by Section 809X in respect of clothing, footwear and jewellery purchased out of relevant foreign income for personal use. Unfortunately, relevant foreign income does not include foreign earnings – they are described as either relevant foreign earnings or foreign-specific employment income. (Do try to keep up.)

Help is at hand, because the Finance Bill extends the scope of the exemption in Section 809X to include property purchased out of foreign employment income.

Whilst this is, of course, welcome, it does not really solve the issues previously highlighted because the exemption is so narrowly drawn. Serious (and absurd) problems remain, which it is hoped will be addressed when this amendment is considered during the Parliamentary process.

Offshore Trusts

The High Court have reversed the Special Commissioners' decision in the case of *Smallwood* and allowed the taxpayer's appeal that capital gains made by his trustees in Mauritius were protected by the UK/Mauritius Double Taxation Agreement.

Mr Smallwood had moved his offshore trust to Mauritius in anticipation of making a gain that would be protected by the Double Taxation Agreement; after the gain was made, the trust became UK resident before the end of the tax year. The reasoning was that if the trust had been non resident the whole of the tax year, the gain made by the trustees would have been taxed on him under Section 86 TCGA 1992. By making the trust UK resident for part of the year, Mr Smallwood had rendered Section 86 inapplicable (it applies only to trusts that are not resident for the whole of the year) and the Double Taxation Agreement with Mauritius came into play.

The taxpayer failed before the Special Commissioners on the grounds that the trust should always have been treated as resident in the United Kingdom under the tiebreaker test in the Double Taxation Agreement. This judgment was disturbing because the Special Commissioners found that although the actions of the trustees in Mauritius were carried out correctly and all relevant activities were undertaken there, they felt that the influence of the settlor who had power to appoint new trustees and the guiding hands of senior advisers of KPMG in the United Kingdom meant that the trust was really UK resident.

This seemed like dynamite at the time – the influence of the settlor and the guidance of the advisers effectively usurping the position of the trustees. Fortunately the High Court did not agree and have concluded that although the trust later became resident in the United Kingdom, it was resident in Mauritius when the gain was made. The Double Taxation Agreement gave the right to tax capital gain to the state in which the trust was resident at the time of the disposal. The gain was therefore not chargeable to tax in the United Kingdom.

HMRC sought to invoke the tiebreaker provisions by claiming that the trust was resident in both territories by reason of the influence of the settlor and the advisers. The High Court held that at the time of the disposal, the trust was resident in Mauritius and there were no two jurisdictions vying for residence in that period, so no tiebreaker was necessary.

I do not suppose we have heard the last of this case.

Furnished Holiday Lettings: EEA

Income from furnished holiday accommodation in the United Kingdom is treated as a trade for tax purposes. The letting of property is not a trade, but some of the tax rules applicable to traders are applied to those with furnished holiday lettings. These include loss relief, capital allowances and the income accounts as relevant earnings for pension purposes.

However, this treatment is confined to property situated in the United Kingdom, and HMRC have been advised that this is not in accordance with EC law. It may be remembered that they received similar advice regarding agricultural property and woodlands, and in the Budget it was announced that the relief would be extended to all agricultural property in the European Economic Area (EEA). Not so with furnished holiday accommodation. These rules are going to be repealed from 6 April 2010. However, until that time HMRC will regard the furnished holiday accommodation rules as applying to such accommodation elsewhere in the EEA.

HMRC will also accept amendments to tax returns that are within the normal time limits. In addition, until 31 July 2009, they will accept late amendments to individual tax returns for the year ended 5 April 2007 and corporation tax returns for periods ending on or after 31 December 2006.

Finance Bill 2009

The Finance Bill was published today in multiple volumes containing the draft legislation for all the matters (and more) covered in the Budget Bulletin issued last week. Further details on any aspect are available on request.

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