SQUIRE SANDERS | LEGAL COUNSEL WORLDWIDE

UNITED KINGDOM TAX BULLETIN

Squire, Sanders & Dempsey

June 2009

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CURRENT RATES June 2009

Indexation

Retail price index: June 2009	212.8
Inflation rate: May 2009	(1.07%)

Indexation factor from March 1982:

to April 1998	1.047
to May 2009	1.679

Interest on Overdue Tax

Income tax/CGT/NIC	2.5%	from	24 March 2009
Inheritance tax	zero	from	24 March 2009
VAT	2.5%	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%

New Disclosure Opportunity

Everyone will remember the amnesty a couple of years ago during which people were encouraged to disclose previously unreported income and submit to a mitigated penalty. HMRC did not like it being called an amnesty. They preferred the term "offshore disclosure facility". Those who failed to disclose under this amnesty were going to be subject to investigations that could be "intrusive and thorough". Well, nearly. In the Budget, Mr Darling announced that those who did not come clean before will be given another opportunity to do so – I wonder what happened to the "intrusive and thorough" investigations. All they now say is that they "will pursue those who do not disclose".

Details of the new amnesty have now been announced – this one is called the New Disclosure Opportunity. You have to smile. Picture the scene. Man in balaclava goes into bank and says to cashier: "See this gun? I would like to offer you an opportunity . . ."

Anyway, this new amnesty is intended to encourage taxpayers to disclose income otherwise not declared to the UK tax authorities, providing one of the sources is an offshore account. It will run from autumn 2009 until March 2010. A penalty of 10 percent will be imposed for full disclosure providing there was no previous opportunity to make this disclosure. If there was, there will be a higher penalty.

By way of further encouragement, HMRC mention that they are seeking to obtain details of offshore accounts and assets from hundreds of financial institutions – and, as will have been noted from previous *Bulletin*s, they have been extremely successful in obtaining court orders for such disclosure. Accordingly, HMRC suggest that all account holders will know that HMRC has, or will soon have, their details – so they had better get on with their disclosure or there will be trouble (see where the gun comes in?). HMRC prefer to say that taxpayers who do not disclose "will be disappointed" because they will face the likelihood of HMRC contacting them after the disclosure window has closed and imposing a higher penalty.

Review Procedure

We are all finding our feet with the new tribunal system, and one of the new aspects is the opportunity for the taxpayer to ask HMRC to conduct an independent review of the relevant decision before appealing to the tribunal. The guidance notes provided by HMRC explain that the review will be undertaken independently and by somebody outside the line management of the

persons making the determination. The person conducting the review has 45 days to complete the review, during which time the taxpayer's right of appeal goes into suspension. After 45 days (unless an extension is agreed upon), the taxpayer's right of appeal to the tribunal is revived.

Having now become involved in such reviews, I find it apparent to me that they are of only limited benefit. In fact, they seem to be of no benefit at all in any technical dispute. I recently asked for an independent review of a determination on a technical point. If the head of the relevant HMRC office makes a determination, it is difficult to understand how anybody in the same office can sensibly review that decision. Such a person is, by definition, likely to be less senior and less expert on the subject, and who on earth is going to do anything other than conclude that the boss was right? And so it proved. The reviewer of the determination for which I requested review was from the same office as the HMRC office head who made the decision, and that reviewer freely acknowledged that his "technical expertise was not as proficient as the officers responsible for issuing the determination". Oh, great.

However, the reviewer was able to confirm that the correct procedures were undertaken; action was taken to establish and verify the facts, and appropriate advice was taken and suitable legislation considered. A great comfort – but was that ever in doubt? How about considering whether the decision in dispute is likely to be right or wrong? This is a review prior to the case going to the tribunal, so one might have thought that the review would cover the technical issue that was going to be adjudicated. No, sorry. That seems to be outside the scope of the review.

When the idea of a review was first suggested, many people were cynical, but I really thought there was a great opportunity here to provide a mechanism to resolve issues that would otherwise involve the delays and costs of a formal appeal hearing. It could even include an informal meeting, so that the issues and arguments could be fully understood before the precise issues are put to the tribunal. It is greatly to be regretted that this is not the case.

Employee Expenses Deductions

I have said many times in these pages that the rules for the deduction of expenses from employment income are so strict that it is virtually impossible to find any expenditure that is deductible. The test is set out in Section 336 ITEPA 2003. To qualify for relief, the employee must show that the expenditure is:

Incurred wholly exclusively and necessarily in the performance of the duties of the employment.

In August 2006 I made reference to the case of *Consultant Physiatrist v HMRC* SpC 557, in which the taxpayer incurred expenditure on professional training that was an essential part of her job. The Special Commissioner said that to the extent that she was required to satisfy the CPD requirement that any holder of the post would need to satisfy, the expenditure would necessarily be incurred by virtue of her employment. Unfortunately, however, that was not enough. The expenditure also needs to be incurred in the performance of the duties of the employment – and it was not. She was a consultant physiatrist, and the best that could be said about her training expenses is that they put her in a position to do her job better.

The reason I make reference to all this again is that there has been another case – *HMRC v Banerjee* [2009] EWHC 62 – concerning a specialist registrar in dermatology in the NHS. She was required to attend courses and conferences prescribed by her supervisor; attendance was compulsory and a prerequisite of her maintaining her post and employment. She claimed a deduction in respect of expenditure incurred by her in attending the courses, and HMRC disallowed the expenditure. This all sounds very familiar. However, the High Court has decided that she was entitled to relief. They said that the deduction claimed by the taxpayer had to be related to an objective necessity imposed by the duties of the employment. Irrespective of what the employer might prescribe, the duties themselves involved the particular outlay.

The High Court also dealt with the requirement that the expenditure had to have been incurred in the actual performance of the duties of the employment and also to have been wholly and exclusively so incurred. They considered that this test was satisfied, too. This had not been a collateral contractual obligation undertaken by her at her employer's request, nor had it been an extracurricular obligation that she had chosen to undertake in order to qualify herself to do her job or improve the prospects of her promotion. Otherwise, it would have been impossible for the test in Section 336 to be satisfied in any case in which the taxpayer was paid to undergo training.

Very interesting. In fact, very interesting indeed, because this is such an enormous departure from the traditional view of the rule relating to employee expenses that a whole vista of opportunity now opens up. Unfortunately, I do not think so. Although the High Court clearly trumps the Special Commissioners, there is ample House of Lords authority to the contrary, and I fear that (as always

with this rule) taxpayers will have been encouraged to take their case to appeal, only to have their hopes dashed when the true meaning is revealed to them. I do hope that I am wrong. We shall see, because there is bound to be an appeal.

What is additionally interesting is that the facts of this case are almost exactly the same as an example in the Revenue Manuals – an example in which HMRC say that the expenditure is deductible. The example is in the Schedule E Manual at paragraph 32545, dealing with a scientist employed by a university:

> *She attends a presentation at a different university of the findings of a scientist working in the same field. She is required to attend such presentations as part of the program of research for which she is employed. The subject matter of the presentation directly influences the content and direction of her own research.*
>
> *The duties of this employment include research. In this case attendance at the presentation is an integral part of the research process and so is one of the duties of the employment. The costs of travel to the presentation are deductible.*

Whatever the technical position, you would have thought that if this is what they publish in their Manuals, HMRC would not argue the opposite when a real case turns up. No attempt seems to have been made to challenge HMRC on this ground – not very technical, but it would have been interesting to see how they tried to explain it away.

Capital Gains Tax: Elections

The recent matter of David Adams, case number TC48 in the First Tier Tax Tribunal, could prove helpful. Mr Adams disposed of some shares that included some deferred consideration. Clearance under the paper for paper provisions under Section 137 TCGA 1992 was granted, and he should have made an election under Section 138A so that the right to the deferred consideration could be treated as a security of the acquiring company. Unfortunately, no such election was made, but Mr Evans submitted his return as if such an election had been made.

HMRC had two claims to make here – the first is that in the absence of an election, the value of the right to defer consideration should have been included in his computation and tax paid accordingly. The second point was that the tax return was incorrect and this represented neglect.

The tribunal was extremely sympathetic. They said that the election under Section 138A did not have to be in any prescribed form and did not have to be in the return. It could be in any form and the guidance given in the CGT Help Sheet was irrelevant. The submission of a capital gains tax computation with the return excluding the deferred consideration could be correct only if Section 138A applied and therefore "any officer with sufficient knowledge of the law who received the return with the computation could not have been under any misapprehension that the appellant wished Section 138A to apply". Wow. Whilst I would not want to look a gift horse in the mouth, I cannot help feeling this is rather generous. Just think, if for some reason it had been to the taxpayer's disadvantage for such an election to be made, it would surely have been quite reasonable for him or her to say that he or she did not make an election and none could be implied, so maybe this gives the taxpayer the best of all worlds. I certainly hope so.

Almost as good are the references to negligence. Of course, there could be no negligence having regard to the above decision because the tax return was not incorrect – but what the tribunal said about it is very interesting. Apparently Mr Adams had relied on his professional advisers. He was entitled to do so, and once this had been made clear, any allegation of negligence against him personally should have been withdrawn by HMRC.

Inheritance Tax: Business Property Relief

Another interesting case from the First Tier Tax Tribunal was *Fourth Earl of Balfour TC69,* which concerned entitlement to business property relief for inheritance tax. This was a Scottish case involving Scots law, and it is rather hard to follow, but there are some features that would appear to be extremely helpful. As far as I can make out, Lord Balfour had an interest in a farming partnership and was the proprietor of a landed estate comprising approximately 2,000 acres that consisted of two in-hand farms, three let farms, 26 let houses and two sets of business premises. There were also some parks, which were let on a seasonal basis.

Lord Balfour made no distinction between the partnership and the estate. His own view seemed to be that everything was run as a single business. The total trading turnover regularly exceeded the letting income for the years under review, but not always by very much.

The tribunal concluded that the whole of the activities represented a single business. That is interesting, because one might have thought that a farming partnership could easily be regarded as a separate activity from the letting of residential and commercial premises.

The next question to consider is whether the business carried on by Lord Balfour consisted wholly or mainly of making or holding investments. That would disqualify it from business property relief by reason of Section 105(3) IHTA 1984. Certainly not, said the tribunal. To suggest that the activities carried on by Lord Balfour consisted wholly or mainly of the making or holding of investments would be to belittle the efforts made by Lord Balfour properly and profitably to manage the various components of such an estate. Even the residential letting aspects required Lord Balfour's experienced business acumen and careful planning. They were an important component in the overall business; the cottages were historically part of the overall farming enterprise or housed full-time estate workers. The tribunal said they had no difficulty in concluding that the business was not wholly or mainly making or holding investments, and it was unnecessary to make any quantitative analysis of the various activities.

The tribunal went on to say that even if they assumed that the letting of the 26 houses and cottages constituted the making or holding of investments, they were not satisfied that the estate management and farming activities represented a business that consisted wholly or mainly of making or holding investments. On this basis, business property relief was available in full.

The key finding here is that the letting of the properties was considered part of the farming business. It might be thought equally reasonable to segregate these activities and to conclude that the separate letting business did consist wholly or mainly of making or holding investments and did not qualify for the relief. Alternatively, in this unincorporated business it would be quite possible to suggest that Section 112 IHTA 1984 applied (excepted assets) because it might be difficult to say that the let properties (other than those let to the farm workers, of course) were used wholly or mainly for the purposes of the farm business. However, Section 112 seems not to have been considered at all.

I have a feeling that we are going to hear a lot more about this.

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