SQUIRE SANDERS | LEGAL COUNSEL WORLDWIDE

UNITED KINGDOM TAX BULLETIN

Squire, Sanders & Dempsey

October 2010

www.ssd.com

SQUIRE SANDERS | LEGAL COUNSEL WORLDWIDE

UNITED KINGDOM TAX BULLETIN

CURRENT RATES	October 2010
Indexation	
Retail price index: September 2010	225.3
Inflation rate: September 2010	4.6%
Indexation factor from March 1982:	
to April 1998	1.047
to August 2010	1.826
to September 2010	(not yet announced)

Interest on Overdue Tax

Interest on all unpaid tax is charged at the same rate.

The formula is Bank base rate plus 2.5% which gives a present rate of 3%.

There is one exception: Quarterly instalments of corporation tax bear interest at only 1.5%.

Repayment Supplement

Interest on all overpaid tax is payable at the same rate.

The formula is Bank base rate minus 1% but with an overriding minimum of 0.5% which applies at the present time.

Official Rate of Interest: From 6 April 2010 4%

Discovery Assessments I

It will be well known that HMRC are only entitled to raise an assessment beyond the enquiry window if they discover that there is income which has not been assessed or that an assessment to tax is insufficient. The provision of the enquiry window was an important feature of self-assessment, described by Park J. in *Langham v Veltema*:

> *"[Self-assessment] imposed new burdens on taxpayers by requiring them to submit fuller tax returns than have previously been required. … The new burdens were balanced by new protections for taxpayers who conscientiously comply with the system, in particular by new and tighter time limits on the power of the Revenue to make further tax assessments."*

Unfortunately, that protection has proved to be illusory. The latest example is the case of *Hankinson v HMRC* FTC 14/2010 in which Mr Hankinson appealed against a discovery assessment on the basis that it did not satisfy the statutory conditions. We know from earlier cases that there must be a basis for the officer's decision to raise the assessment; it must be more than a suspicion and cannot be mere conjecture.

HMRC acknowledged that the officer must be satisfied that he has discovered an insufficiency of tax; the Tribunal confirmed that "the officer must of course have made a discovery. Unless he has done so, he cannot raise an assessment".

Mr Hankinson argued that there was no discovery; the assessment had been issued without any consideration at all. It was issued only six days before the expiry of the time limit and was described as a protective assessment by the Inspector of Taxes.

Mr Hankinson said there was no evidence before the Tribunal that the assessing officer had considered the necessary conditions for making the assessment – he had not discovered anything; he simply raised the assessment because he was running out of time.

If it is right that there was no evidence before the Tribunal that the assessing officer had considered the conditions before he made the assessment, it is difficult to see how HMRC could expect to succeed. However, the Tribunal took the view that it was hardly credible that the Inspector was unaware of the requirements – and that it was highly improbable that the Inspector failed to consider the conditions.

I am sure I am not the only person who will feel uneasy at the idea that in the absence of any evidence, satisfaction of the conditions can simply be assumed. Generally, when conditions need to be satisfied, one has to show that one has satisfied them. I think that is the rule which applies to the taxpayer.

It is difficult to see how in this case these requirements were satisfied – although I did notice that the First Tier Tribunal made a specific finding that a discovery had been made. So maybe that was game over.

Discovery Assessments II

However, there might be some light at the end of this particular tunnel. In *HMRC v Lansdowne Partners Limited Partnership* [2010] EWHC 2582 (Ch), the circumstances in which HMRC can make a discovery assessment outside the enquiry window were revisited.

When an officer of HMRC discovers that a self-assessment is or has become insufficient, he can make an amendment to bring the insufficiency into charge to tax. However, it is crucial that the officer could not reasonably have been expected, on the basis of the information supplied to him by that time, to be aware of the insufficiency. The only information to be considered for this purpose is that supplied to the officer by the taxpayer on his agent. That information must clearly alert the officer to the insufficiency of the assessment.

So you are left with the impossible conundrum that when a person believes (on good grounds) that his tax return is correct and therefore has no reason to believe there is any insufficiency, he cannot then "clearly alert the officer to the insufficiency" – and by failing to do so, he leaves the door open to HMRC to raise the assessment on grounds of discovery. However, if he knew that his tax return was incorrect, then HMRC would be able to raise an assessment on the grounds that he had knowingly submitted an incorrect return. When I was younger, this used to be called Catch 22.

These points are not new and have never cut any ice before – but the case of *Lansdowne* does seem to offer some relief. The issue related to whether certain payments made by the taxpayer were properly deductible from the trading profit. The court said that the correct question is whether the officer had known enough about the payments to enable him to decide whether to raise an additional assessment within the time limit.

This is a serious advance and provides a much more satisfactory code for the taxpayer. Providing the taxpayer has given adequate information to the officer (it needs to be the particular officer – it

is not enough to say that the information may be found in the vaults of HMRC), he should be safe. The taxpayer is entitled to say that if HMRC wanted to disagree with his self-assessment, or challenge a claim or deduction, they had all the information necessary to do so before the expiry of the enquiry window.

It is important to put these issues in the right context. This is not a matter of somebody making a claim and arguing about it. We are looking here at somebody who is not paying tax on some income when he should have done so, or he is getting a tax deduction for something to which he is not entitled simply because HMRC did not get around to correcting the matter in time. Put that way, one can have some sympathy for the idea that the position ought to be corrected so that the right tax is payable. However, the finality given to the taxpayer by the enquiry window is a fundamental point of the balance of obligations which was the whole basis of self-assessment. If taxpayers do not meet their obligations by the time limit, they pay the penalty. It is only fair that if HMRC fail to meet their obligations within the time limits which apply to them, they should not be excused from the consequences.

SDLT and LLPs

HMRC have revised their view about the availability of Stamp Duty Land Tax (SDLT) group relief when transactions take place between members of a group which includes a limited liability partnership (LLP).

HMRC have traditionally taken the view that when considering whether a group relationship existed, LLPs were regarded as transparent and the members of the LLP were treated as the beneficial owners of the LLP assets.

However, HMRC now accepts that for the purposes of SDLT group relief, a body corporate does include an LLP and an LLP can therefore be the parent in a group structure. (However, an LLP does not itself have an ordinary share capital, so it cannot be a subsidiary of any other company.)

This sounds like a helpful new interpretation, but actually it is awful. It means that subsidiaries of the LLP cannot be grouped with companies that are corporate members of the LLP.

An LLP cannot claim group relief itself because its chargeable interest in land is treated as being held by the individual members. Accordingly, if an LLP transfers land to a company that it owns, no group relief would be available because the land is deemed to be owned by the members of the LLP and those members are not within the same group as the company owned by the LLP.

This new view does not apply to general partnerships because a general partnership is not a body corporate like an LLP, so companies that are partners of an UK-based general partnership can be grouped with those companies that are below the partnership in the group structure.

Legal Professional Privilege

No sooner had we received the judgment from the European Court of Justice that legal professional privilege did not extend to in-house lawyers, but we get the Court of Appeal judgment in *Prudential v HMRC* confirming that it does not extend to accountants or any other non-legally qualified tax adviser either. Accordingly, documents bought into existence for the purpose of obtaining and giving legal advice will not be disclosable to HMRC when the adviser is a lawyer, but they will where the adviser is an accountant.

There were lots of interested parties in this case. Quite apart from the taxpayer, it was really a battle between the professional bodies (and HMRC), with some seeking to confine legal professional privilege to lawyers and others arguing that it should be extended to accountants whose advice on tax matters was of the same nature.

Clearly there is something not quite right about the disclosure requirement depending on whether the taxpayer consults a lawyer or an accountant. The accountants claimed that there should be a level playing field and that the current position was anticompetitive because taxpayers will be at a disadvantage if they seek advice from an accountant rather than a lawyer.

HMRC are not keen on privilege anyway, taking the view that they should be entitled to see everything which is relevant to a taxpayers' tax affairs so that they may charge tax where it is properly due; they should not be prevented from doing so by being denied relevant documents. You can see their point, but it is not quite as simple as that. It is incredibly undermining of any professional relationship if everything the client says to his lawyer and vice versa will end up being copied to HMRC. And just think of the position of the client who seeks the advice of counsel on a tax problem. Counsel give full and comprehensive advice setting out the strengths and weaknesses of the client's position. That is what counsel do. HMRC would not have to do anything; they would just have to get hold of the counsel's opinion which would set out all their arguments for them – and all free.

The Court of Appeal made it clear that they were bound by the authorities on this subject not to extend legal professional privilege beyond solicitors, barristers and appropriately qualified foreign

lawyers. They added that even if they were not bound by precedent, they would have concluded that privilege can only extend beyond the legal profession by specific statutory provisions.

The Court of Appeal rather disturbingly suggested that the only possible levelling of the playing field would be not to give legal professional privilege to accountants and other tax advisers, but to remove it from lawyers. Wouldn't that be a spectacular own goal?

Pensions Tax Relief

HMRC have announced the new rules relating to pension tax relief which will apply from 6 April 2011. The new system will be comparatively straightforward with an annual allowance of £50,000 for which full tax relief will be given at the taxpayers' marginal rate. It will be possible for unused annual allowances to be carried forward for three years. Interestingly, you must be making contributions to a pension scheme for those three years because otherwise you would not have any "unused annual allowances" to carry forward.

If you pay too much, there will be an annual allowance charge – and it will be the taxpayer's responsibility as a matter of self-assessment to work out that charge and include it on their tax return.

There will also be a reduction in the lifetime allowance from £1.8 million to £1.5 million in 2012, and most of the complicated proposals which were introduced earlier this year will be abolished – but regrettably not the forestalling provisions which will continue to apply for the current year.

Relief for Interest Paid

The recent case of *J S Torkington v HMRC* TC 706 is a helpful decision, giving a wide interpretation to the conditions for relief of interest paid on a loan to a close company. The relevant test in Section 360 Taxes Act 1988 (now Section 392 Income Tax Act 2007) is that the money borrowed must be applied:

> "… *in lending money to [a close company in which he had a material interest] which is used wholly and exclusively for the purposes of the business of the company or of any associated company of it which is a close company satisfying any of those conditions*".

Mr Torkington borrowed money and advanced it to a close company in which he had a material interest, and that company lent the money to an associated company resident in Canada. HMRC said that the money lent to the company was not used wholly and exclusively for the purposes of

its business because it was just lent to another company. The other company was an associated company and used the money for the purposes of its business, it was not a close company because it was not resident in the UK. (That looks right because the company was resident in Canada – if it had been resident in the EU, it would probably have been OK.)

The question was whether when the company borrowed the money from Mr Torkington and lent it to its associated company, it was using the money wholly and exclusively for the purposes of its business. HMRC said it wasn't – it was merely an intermediary providing finance by way of a back-to-back loan to the Canada-based company. However the Tribunal decided that the reference to "business" in Section 360(1)(b) indicated that a flexible and wide approach should be adopted. As these were commercial loans, it represented the carrying on of a business sufficient to satisfy Section 360. There is a celebrated phrase from the case of *American Leaf Blending Co* in 1979 which the House of Lords said:

> "*In the case of a company incorporated for the purposes of making profits with shareholders, any gain for use to which it puts any of its assets* prima facie *to the carrying on of a business*".

In the more recent case of *Jowett v O'Neill & Brennan Construction Limited,* merely having money on deposit was sufficient to represent a business for the purposes of the small companies rate of corporation tax. The case of *Torkington* is further support for the *American Leaf Blending* formulation that the meaning of the word "business" can be extremely wide.

HMRC Toolkits

Three new HMRC Toolkits have been published this month:

- Property Rental
- Capital and Revenue Expenditure
- Director's Loan Accounts

These Toolkits follow the same line as all the others. There is a checklist of things which the taxpayer or his adviser should think about on this particular subject – with the implied risk that only by using the Toolkit (or something better) can you avoid the charge of failing to take reasonable care in dealing with your tax affairs if anything goes wrong. (Whether that conclusion can be submitted is rather unclear, but we shall see.)

I still think that the target market for these Toolkits is confused because some parts are extremely elementary and of no relevance to a professional adviser and other parts assume a degree of knowledge which only a professional would have. Anyway, on the whole they look like jolly good things.

One expects the guidance contained in these Toolkits to reflect the Revenue view – but sometimes I think they overdo it. In the Director's Loan Accounts Toolkit, they refer to the importance of transactions being contemporaneously posted to the Director's Loan Account. This is an odd idea for most close companies. Few will post expenditure to Director's Loan Accounts immediately after it is incurred. I imagine that in most cases, this happens at the year end – and only after a good deal of consideration to identify the proper accounting treatment. The idea that small companies post every transaction to the right account contemporaneously betrays a lack of understanding (or perhaps just wishful thinking) on the part of HMRC.

It is interesting that the Toolkit is entitled Director's Loan Accounts because for the most part, the issues relate to loans to participators and the obligation under Section 419 TA 1988 (now Section 455 Corporation Tax Act 2010) to make a payment of 25% of such a loan until it is repaid. Admittedly, the relevant participator will often be a director, and HMRC are also highlighting the implications relating to beneficial loans, but it is unusual for them to be so imprecise.

One controversial area is where the participator has more than one account with the company. He may have lent the company some money and some time later withdraws money from the company. The company might for its administrative purposes choose to separate these transactions into different accounts, and HMRC take the view that if there is more than one account, a liability under Section 419 applies in respect of the account which is in debit even if there are others which are in credit. That may be their view but it is seriously controversial, and really this Toolkit is hardly the place for it to be promulgated.

This is interesting in the context of another controversial area – the relevant time when credits are treated as being made to the loan account. To avoid an overdrawn loan account at the year end, a bonus may be voted or a dividend declared or paid. It is obviously important for entitlement to the bonus or dividend to arise before the year end if it is to be credited to the loan account. The precise time when the entitlements arise therefore needs to be identified. However, the technical difficulties involved in connection with the payment of interim and final dividends are not even mentioned.

Peter Vaines
Squire, Sanders & Dempsey
29 October 2010

SQUIRE SANDERS | LEGAL COUNSEL WORLDWIDE

UNITED KINGDOM TAX BULLETIN

Contact:

Peter Vaines
+44.20.7189.8191
pvaines@ssd.com

Articles and Publications – October 2010

Peter Vaines: *New Law Journal*

TAXline

Malcolm Gunn: TAXline Annual 2010

Subscription Information

Squire Sanders & Dempsey 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 **www.ssd.com/subscribe**.

Published by:

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

Beijing
Bratislava
Brussels
Budapest
Caracas
Cincinnati
Cleveland
Columbus
Frankfurt
Hong Kong
Houston
Kyiv
London
Los Angeles
Miami
Moscow
New York
Palo Alto
Phoenix
Prague
Rio de Janeiro
San Francisco
Santo Domingo
São Paulo
Shanghai
Tallahassee
Tampa
Tokyo
Tysons Corner
Warsaw
Washington DC
West Palm Beach

Independent Network Firms:
Beirut
Bogotá
Bucharest
Buenos Aires
La Paz
Lima
Panamá
Riyadh
Santiago