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# UNITED KINGDOM TAX BULLETIN

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| CURRENT RATES | June 2011 |
|---|---|
| Indexation | |
| Retail price index: May 2011 | 235.2 |
| Inflation rate: May 2011 | 5.2% |
| | |
| Indexation factor from March 1982: | |
| to April 1998 | 1.047 |
| to April 2011 | 1.951 |
| to May 2011 | (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%

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## Residence – Statutory Test

Proposals for a new statutory residence test were published by HMRC on 17th June. They are to apply for income tax and capital gains tax - but not for national insurance contributions.

The test is (naturally) a bit complicated but certainly the proposals have the advantage of much greater certainty. Some of the definitions are a little vague, but this is still an improvement. (Mind you, anything is an improvement over the existing position which even the Treasury now describe as unclear, complicated and "seen as subjective". That's funny – they have been arguing for years that IR20 was clear and straightforward.)

These rules will supersede the existing rules and represent a complete code – but they will not have any relevance to the position prior to 2012/13, so the existing uncertainties will continue for a while.

The new proposal is for there to be a 3 part test. Part A can make you conclusively non-resident. Part B can make you conclusively resident. If neither of these conclude your position, you have to look at Part C where the number of days you are allowed in the UK will depend on the number of your connecting factors. The general idea is that someone who has been UK resident for 3 years will find it more difficult to shed UK residence status than someone who has not.

**Part A - says that you will be conclusively NON-RESIDENT if:**

1. You were not resident in the previous 3 years and you spend fewer than 45 days in the UK in the tax year; or

2. You were resident in any of the last 3 years and you spend fewer than 10 days in the UK in the tax year

3. You leave the UK to carry out full time work abroad and spend less than 90 days in the UK in the tax year and no more than 20 days working the UK for at least 3 hours a day.

If you satisfy any of these tests you will be conclusively non-resident whatever else may happen.

If however you breach any of these limits you cannot satisfy Part A so you would not be conclusively non-resident. But that would not make you resident. It would just mean you have to move to the next element of the test which is in Part B.

**Part B - says that you will be conclusively RESIDENT** if:

1. you spend more than 182 days in the UK; or

2. have only one home which is in the UK (or only UK homes);

3. carry out full time work in the UK.

If you satisfy any of the tests in Part B then you are definitely resident. (You do not get to Part B if you satisfy any of the tests in Part A. If you fall within both parts, then Part A takes priority and you are non-resident.)

But if Part A does not make you conclusively non-resident and Part B does not make you conclusively resident - you have to move on to Part C.

**Part C - this provides 5 connecting factors for the UK:**

1. spouse or minor children being resident in the UK;

2. the existence and use of accessible accommodation in the UK;

3. substantive work done in the UK

4. more than 90 days in the UK in either of the previous two years;

5. more time in the UK than any other single country; (this is applicable to “leavers” only).

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The importance of these factors depends upon whether you are an "arriver" (someone who was not resident for the last three years) or a "leaver" (someone who was resident in UK for any of the last three years).

An arriver will be resident by reference to a combination of day count and the connecting factors according to the following table:

| Days in the UK | Factors |
|---|---|
| 0 - 44 | Always non-resident |
| 45 - 89 | 4 factors = resident |
| 90 -119 | 3 factors = resident |
| 120 -182 | 2 factors = resident |
| over 182 | Always resident |

A leaver will be resident by reference to a combination of day count and the connecting factors according to the following table:

| Days in the UK | Factors |
|---|---|
| 0 - 9 | Always non-resident |
| 10 - 44 | 4 factors = resident |
| 45 - 89 | 3 factors = resident |
| 90 - 119 | 2 factors = resident |
| 120 -182 | 1 factor = resident |
| over 182 | Always resident |

The following points need to be taken into account when drawing conclusions from the above:

a) Full time work in the UK means 35 hours a week for more than 9 months with no more than 25% of the duties outside the UK.

b) Substantive work in the UK means 40 working days in the tax year.

c) A working day is more than 3 hours – and counts whether or not you are in the UK at midnight.

d) The statutory day (or rather night) count rules in Section 24 FA 2008 will apply in the same way to determine the number of days in the UK.

The proposals are likely to be revised before they come into force on 6 April 2012 – but maybe not too much.

**Ordinary Residence**

The proposals for Ordinary Residence are much less well defined and again will only apply for income tax and CGT and not for NIC.

The plan is that a person who is resident will also be ordinarily resident unless they have been non-resident for the last 5 years.

The status of Ordinary Residence would be available for the tax year of arrival and possibly the next two tax years.

It is intended that the concept of Ordinary Residence will apply only to non-doms.

There is an alternative proposal to abolish Ordinary Residence completely except for the taxation of earnings, preserving the remittance basis for overseas earnings.

## Taxation of Non-Doms

HMRC also published some proposals for the taxation of foreign domiciled individuals broadly following the announcements made in the Budget. There are 5 main issues:

1. The non-dom charge is to be increased from £30,000 to £50,000 for those who have been resident for twelve of the last fourteen years. Everything else regarding the non-dom charge is unchanged.

2. The rules relating to nominated income have been simplified. Serious disadvantages exist if an individual remits some of their nominated income and gains to the UK. It is



3. proposed that the first £10 of nominated income or gains may be remitted free of tax and without becoming subject to the identification rules.

4. Foreign currency bank accounts have caused many complications because foreign currency is a chargeable asset and any withdrawal of funds from such an account represents a part disposal on which a capital gain or loss can arise. It is proposed that individual foreign currency bank accounts will be removed from the scope of capital gains tax.

5. Where an asset has been purchased out of foreign income and is brought to the UK, it is now regarded as a remittance of that foreign income. Certain assets are exempt from this charge (personal assets, assets temporarily imported or assets worth less than £1,000) but if they are sold, the sale proceeds are regarded as having been remitted. It is proposed that this charge will not arise if all the proceeds from the sale are removed from the UK within two weeks of the money being received by the individual.

6. Investments in the UK business. The most significant proposal relates to the exemption from the remittance basis of funds which are brought to the UK for investment in a qualifying business. At the moment, the remittance of foreign income or gains is liable to tax regardless of how the money is used and it is proposed that any income or gains remitted to the UK for commercial investment will not be liable to tax as a remittance.

   There are two main categories of qualifying businesses – trading companies and companies developing or letting commercial property. It is recognised that the letting of commercial property may not represent a trade and it is therefore to be specifically included as a qualifying business. (The relief will not extend to the holding and letting of residential property or any leasing activity.)

   In both cases, the trade or the commercial property activity must constitute a substantial proportion of the overall activities of the company. (This is obviously a point to be clarified, because "substantial" is defined for various tax purposes as being 5%, in other cases 10%, in other cases 20%, and in other cases over 50%.)

This is a very valuable relaxation. However, it will only apply to investments in companies – so investments in unincorporated businesses or partnerships (or LLPs) will not be protected. The target company does not need to be incorporated or resident in the UK but it does need to have a permanent establishment in the UK.

There will be no restrictions on the investor being connected with the business in which they invest – nor is it proposed for there to be any restrictions on the individual working or receiving commercial remuneration from the qualifying business. However, it will not be possible for him to buy an existing business from himself or a connected party – and of course there will be anti-avoidance provisions to prevent the value of the investment leaking out to the investor by indirect means.

The proposals specifically contemplate the investment in UK businesses may be made using funds held in off-shore companies and trusts without attracting a tax charge on the remittance.

When the investment is disposed of, the money must be removed from the UK within two weeks from the individual receiving the money or it will be treated as having been remitted. It will be possible to reinvest the funds in another qualifying business without the need to take the money out of the UK – but again this would need to take place within two weeks.

It is anticipated that these relaxations to the remittance basis rules will come into force on 6 April 2012 and it is said that there will be no other changes in respect of the taxation of foreign domiciled individuals for the rest of this Parliament.

### Overseas Partnerships

The residence of a partnership is not generally an issue for tax purposes. UK partnerships are not themselves liable to tax. The liability to tax is that of the partners and it is the residence of the partners which is important. It is for this reason that in 2006 HMRC discontinued their practice of issuing certificates of residence for partnerships.



What is relevant for UK tax purposes is where the business of the partnership is carried on. This is the effect of Section 111 and 112 TA 1988 which deal with the tax treatment of partnerships controlled abroad. The key test in Section 112 is whether “the control and management of the trade, profession or business is situated outside the UK” because this will determine the tax treatment.

The recent case of *Mark Higgins Rallying v HMRC* TC 1200 analysed the requirements for this test. The conclusion of the tribunal was that the appropriate tests for the location of control and management of the partnership should be the same as those which apply to companies. This means that all the issues examined in *Untelrab, Wood v Holden* and in the more recent case of *Laerstate* are relevant here. The place where the partners meet (or sign documents) is important, but not conclusive; it is where the real management at the highest level takes place which is conclusive.

## Taxpayer Negligence

The recent case of *Colin Moore v HMRC* FTC/82/2010 is rather alarming and represents a clear warning to anybody enclosing information with their tax return. Mr Moore submitted his tax return for 2003/4 and included in his tax return some details of his bank interest. He thought (wrongly) that he could deduct losses from his bank interest and included the net figure in his tax return. However he enclosed all the relevant details and his calculations on separate sheets submitted with his tax return. It was accepted that the information he provided was sufficient for HMRC to calculate his tax liability accurately. However, HMRC claimed he had been negligent and the Upper Tribunal agreed. They said that the entries in the boxes on his tax returns were the things which were important and setting out all the relevant information (no matter how comprehensive) in an additional sheet did not help him.

That sounds a bit worrying but the reasoning is worse. The reason why he was negligent is because he did not follow the guidance published by HMRC or complete the relevant working sheets which had been enclosed with the return. Although these sheets have no statutory force, it seems that if you fail to adhere to them, you will be negligent. To be penalised by HMRC simply

for not following their non-statutory guidance seems to be going a bit far – but that would appear to be the position.

This case specifically deals with the guidance notes enclosed with the tax return – but the argument is surely no better (or worse) where other guidance has been issued by HMRC, perhaps on their website or in their manuals.

I wonder what the position would have been had Mr Moore had included all the relevant details in the white space within the tax return. Maybe his "self-assessment" would still have been incorrect and therefore negligent but maybe completing the white space within the return would have protected him.

### HMRC Advice: Non Business Enquiries

HMRC are introducing a replacement for Code of Practice 10 (Information and Advice) on 30 September. It will be called CAP1 and will be their practice note on dealing with non business queries about the interpretation of recent legislation. They do not explain the distinction between a business taxpayer and a non business taxpayer or what is a business activity, but I doubt whether that will cause any real difficulty. A helpful checklist is provided which must be completed in all cases. Enquiries about matters relating to business activities are dealt with by a separate practice.

HMRC will not give any planning advice under this practice or give any kind of approval to proposed arrangements – and they will obviously not respond to enquiries about tax schemes.

HMRC do envisage that people might contact them for clarification about a proposed transaction and confirm that they will respond – providing they are satisfied that the transaction will take place as described. There is obviously a fine line here between seeking such clarification and HMRC approving the proposals in some way.

If having sought advice from HMRC and received their view, you do not have to agree with it (or follow it) but if you adopt a different interpretation, this would need to be disclosed in your tax return.

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