SQUIRE SANDERS HAMMONDS | LEGAL COUNSEL WORLDWIDE

UNITED KINGDOM TAX BULLETIN

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September 2011

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CURRENT RATES	September 2011
Indexation	
Retail price index: August 2011	236.1
Inflation rate: August 2011	5.2%
Indexation factor from March 1982:	
to April 1998	1.047
to August 2011	1.972
to July 2011	1.954

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%

Autumn Statement

This will take place on 29 November. It used to be called the Pre Budget Report but that has apparently been scrapped. Whatever it is called, I hope it will include the latest position on Disguised Remuneration and the statutory residence tax where various improvements (or at least revisions) have been promised. A disincorporation relief is being considered and some changes to capital allowances. Some tax cuts for business to provide growth have been indicated by the Chancellor – but best not get your hopes up.

Switzerland

HMRC have issued further details of their agreement with Switzerland. It will be remembered that accounts held in Switzerland by UK residents which are not disclosed to HMRC will be subject to a tax charge of between 19% and 34% depending on how long the account has been opened. It will apply to accounts which are in existence on 31 December 2010 and are still open on 31 May 2013. After that date there will be a withholding tax on subsequent income of 48% on income and 27% on capital gains.

HMRC say that people have three options. They can suffer the withholding tax; they can make a disclosure to HMRC (directly or by other means, for example through the Liechtenstein Disclosure Facility) or they can transfer the money somewhere else. The hope is that there will soon be nowhere where funds can safely be transferred. Apparently Switzerland will be supplying HMRC with the top ten destinations where funds leave Switzerland and obviously those territories will be targeted next.

There has been uncertainty regarding the treatment of non-doms and HMRC have confirmed that non-doms who are resident in the UK will not be subject to the withholding tax in Switzerland. However, HMRC are concerned about non-dom status being used to mask impropriety. They say

"if non-doms are not straightforward with us in relation to their tax affairs we will prioritise criminal investigations of people in that position. It is important that people know where they stand".

It is not at all clear what this means – but I think I get the picture.

HMRC take the view – they may be right, but it sounds a bit extreme – that 80% of UK residents with money in Switzerland are concealing it fraudulently and there may be 20% who are "potentially innocent people". I am not sure I am comfortable about the concept of "potentially innocent people" but it will be interesting to find out the accurate figures in due course. It is nice to know that if anyone does suffer withholding tax wrongly, HMRC say it will be repaid to them.

The Swiss have agreed to provide a limited response to the exchange of information article in the double taxation agreement by giving HMRC information on 500 people, However, there is some kind of a ratchet.

If HMRC is successful in identifying people who have additional tax liabilities, there will be an increase in the number about whom they will be permitted to seek information. If they are not successful in identifying people who have hidden money, the figure of 500 will be reduced.

Further details of the agreement will be published quite soon and there is some suggestion that some guidance will be issued to assist in the understanding of the agreement.

Gifts Out Of Income

There has been considerable discussion lately about the exemption from IHT in respect of gifts out of income under Section 21 IHTA 1984. This is a particularly valuable relief, not least because it is unlimited, being subject only to the requirements that the gifts must be:

(a) part of normal expenditure;

(b) made out of the individual's income;

(c) made when there was sufficient income remaining to maintain the normal standard of living.

The recent discussion has centred around whether the 5% withdrawals from a single premium policy are income for this purpose. HMRC have recently updated their Manuals to confirm their view – which is that such withdrawals are not income for the purposes of the Section 21 exemption. They consider that although income is not defined, it should be determined in accordance with normal accountancy rules.

Although the 5% withdrawal has always been regarded as a partial repayment of capital, that is just an artificial division made for tax purposes; it could equally well (if one looked at it as a matter of pure accountancy) be regarded as an income return or the yield from the investment. In any event, it is an amount withdrawn by the policyholder in the nature of income and I expect in most cases is disbursed in exactly the same way as their other income. This would certainly seem to satisfy the HMRC test of the money representing income on normal accountancy rules. This used to be the approach adopted by HMRC but they have changed their mind and now take the opposite view.

Whether we agree with this analysis or not, HMRC are perfectly entitled to their view and where a dispute arises, the proper forum for resolving the dispute is the Tax Tribunal. As long as HMRC do not attempt to impose this new view retrospectively by saying that this was always their view and we must all have misunderstood (ring any bells?), there can be no objection.

A less satisfactory element in the revised Manuals is the suggestion that if a person receives a payment from an insurance policy which is chargeable to income tax, HMRC will not regard it as income for the purposes of the exemption for gifts out of income. Whilst I can see some technical justification for this

conclusion (which is really only the corollary of the point made above on the 5% withdrawals) it is a breathtakingly unattractive argument to claim that something is income for the purpose of charging tax but not for the purpose of giving a tax relief. There could hardly be a better example of how HMRC can bring themselves into disrepute in the mind of the ordinary taxpayer – which is not what they need right now.

Double Trust Schemes

HMRC has issued some updated guidance on the pre-owned assets charge and in particular setting out their revised view on double trust or home loan schemes. In broad terms this involves a sale of a house at full value to Trust 1 with the sale proceeds left outstanding. The vendor continues to occupy the house. The debt is settled on Trust 2 for the vendor's family.

HMRC take the view that by not calling in the loan the trustees in Trust 2 enable the vendor to benefit from the debt (because otherwise the house would have to be sold) and he therefore has a reservation of benefit in respect of the gift to trust 2. Alternatively, if the trustees are somehow constrained from calling the loan, HMRC say that such an arrangement is a pre-ordained series of transactions. The *Ramsay* doctrine applies – the composite transaction has the effect that the vendor has made a gift of the property and has continued to live there – and therefore it is a gift with a reservation.

(This is a serious argument and it is inappropriate to whinge about it, but I cannot avoid drawing a parallel with a trip to Paris on the Eurostar. I could have gone by air and I would have paid the air passenger duty. In either case I started in London and ended up in Paris. The result is the same as if I had gone by air so maybe I should pay the tax as if I had gone by air. I do not see that it makes any difference if I went on the Eurostar specifically because I did not want to pay the tax.)

Anyway moving on, HMRC say that the matter is the subject of litigation and in the meantime they suggest (but only suggest) that those paying the pre-owned assets charge should continue to do so knowing that HMRC will repay it with interest should it prove not to be payable – irrespective of any time limits for repayment that might otherwise apply.

Presumption of Continuity

The recent tax tribunal decision in Dr Syed v HMRC TC 1776 has been bothering me. On the face of it, this was a straightforward case of HMRC denying a tax deduction for some of the expenses in a sole trader's accounts. It would appear that some negotiations took place and Dr Syed's accountants eventually agreed some adjustment to the computations. Sounds pretty normal.

HMRC then decided that they would raise assessments for the previous four years on the grounds that they claimed were justified by the "presumption of continuity" – a phrase which derives from the case of Jonas v Bamford 51TC1, in which the High Court said:

> "O*nce the Inspector comes to the conclusion that on the facts which he had discovered, Mr Jonas has additional income beyond that which he has so far declared to the Inspector, then the usual presumption of continuity will apply. The situation will be presumed to go on until there is some change in the situation, the onus of proof of which is clearly on the taxpayer*".

The tribunal considered this passage and concluded that it expressed no legal principle saying that as a matter of law it would be quite wrong to assume that because something happened in one year it must also have happened in the prior year. They considered that the Court was merely expressing a common sense view. The Tribunal said:

> "*it will generally be reasonable and sensible to conclude that if there was a pattern of behaviour this year then the same behaviour will have been followed last year. Sometimes however that will not be a proper inference: there will be occasions when the behaviour related to a one-off situation perhaps a particular disposal, or particular expenses; in those circumstances continuity is unlikely to be present. In the circumstance of Jonas v Bamford there had been undeclared income in a particular year and it was not unreasonable to conclude that the same habit of concealing income had been followed in previous years*".

Quite so. This is just common sense. If somebody is in the habit of deliberately concealing taxable income one may take a rather unsympathetic view. However Dr Syed was not in the habit of doing anything improper. He had professional tax advisers who would have approved the deductions claimed – even if they did not make them on their own initiative. It is going a bit far to suggest that because his accountant claimed for some expenses which HMRC were able to argue were not fully allowable, this means that Dr Syed was in the habit of impropriety to justify discovery assessments for the previous four years. Indeed, the passage from Jonas v Bamford quoted above would not seem to authorise retrospective application it merely says that

"the situation will be presumed to go on until there is some change" which seems only to deal with the position in the future.

Even the HMRC Manuals do not suggest that the presumption of continuity can be used to reopen earlier years. Furthermore, they say that the presumption of continuity alone does not justify increases in assessments, the onus being on HMRC to bring evidence in support of the argument.

Despite all this, and despite the absence of any suggestion that there was anything wrong in the previous years, HMRC concluded that because they were able to agree a disallowance of expenditure in one year, they were entitled to assess tax for the earlier years without any further justification.

The Tribunal agreed with them on the grounds that there was no evidence that HMRC were wrong – a bit surprising as there was no evidence that they were right either. It seems to me that this deserves some critical examination.

We know that once HMRC has raised an assessment the onus of proof is on the taxpayer to show that on the balance of probabilities it is excessive. However, this case goes much further and takes the onus of proof to a whole new level. Not only does this seem to be inherently unjust and unreasonable but it is stretching the decision in Jonas v Bamford way beyond breaking point.

Woe betide anybody who agrees a disallowance or an adjustment in their tax computations. On the basis of this decision, such agreement could have rather more expensive consequences than they might have thought.

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