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UK Tax Bulletin

February 2012

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Introduction

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Latest Rates of Inflation and Interest

The following are the current rates from February 2012

Current Rates	February 2012
Retail Price Index: January 2012	238.0
Inflation Rate: January 2012	3.9%
Indexation factor from March 1982:	
to April 1998	1.047
to December 2011	2.014
to January 2012	(not yet published)

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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Double Taxation Relief

In the August Tax Bulletin I mentioned the case of *Anson v HMRC* which related to a claim for double taxation relief for tax paid by Delaware LLC. Mr Anson had been taxed in the US on the profits of the LLC on the basis that the LLC was transparent. Mr Anson received those profits from the LLC which were taxable in the UK. He claimed double taxation relief but unfortunately HMRC regarded the LLC as opaque and denied him any double taxation relief. He therefore ended up being taxed in both countries with no relief either way.

The Upper Tribunal confirmed that this was correct – it was analogous to the LLC paying tax on its profits and Mr Anson receiving a dividend. The fact that the US tax code imposed a transparency for US tax purposes did not matter. These were different sources of income as far as the UK tax was concerned and the test for relief under the treaty was not satisfied.

However, Mr Anson had another argument – that if the transfer of assets abroad provisions in section 739 TA 1988 (now section 720 ITA 2007) applied, then the income of the LLC would be treated for all the purposes of the Income Tax Acts as his income. That sounded like a good argument as it would eliminate at least one of the charges to tax.

This argument has now been considered by the Upper Tribunal. It was common ground that section 739 applied (although the Judge was a bit reluctant to accept this conclusion) but HMRC argued that the bona fide commercial exemption in section 741 prevented the application of section 739.

Section 741 reads as follows:

> *"Sections 739 and 740 shall not apply if the individual shows in writing or otherwise to the satisfaction of the Board either:*
>
> *(a) that the purpose of avoiding liability to taxation was not the purpose or one of the purposes for which the transfer or associated operations or any of them were effected; or*
>
> *(b) that the transaction and any associated operations were bona fide commercial transactions and were not designed for the purpose of avoiding liability to taxation."*

The Upper Tribunal decided that there was no tax avoidance involved here so HMRC were correct in being satisfied that the conditions of section 741 were fulfilled.

However, this was a difficult conclusion because section 741 starts with the specific requirement that "*the individual shows in writing or otherwise to the satisfaction of the Board*". Mr Anson did nothing of the sort. HMRC came to that conclusion all on their own (maybe they were right, maybe not) and although the terms of the section were not satisfied, the Tribunal decided it applied anyway and this knocked out Mr Anson's argument.

The Tribunal was expressly perturbed that Mr Anson was using an anti avoidance provision to his advantage and indicated clearly that this provision is only available to HMRC and not to the taxpayer. It seems rather unsatisfactory that a section which has the effect of providing a benefit to the taxpayer can be denied to him for no other reason than that he is a taxpayer. There is nothing in the section which indicates that the benefit of the law can only apply to HMRC.

I wonder what the position would have been if the taxpayer had been making a claim under section 741. No doubt it would be said that he had failed to satisfy one of the express terms of the section - viz that he had not shown in writing or otherwise to the satisfaction of the Board that the section applied. HMRC usually insist (quite rightly) that taxpayers satisfy all the conditions contained in a section before they can benefit from it. It does not seem right that HMRC do not have to bother.

It might be suggested that section 741 provides a compulsory exemption from section 739 - that is to say, it must apply if the facts show that there was no tax avoidance motive. That may be a desirable conclusion but it surely cannot be right because it completely disregards one of the express conditions of the section.

HMRC Initiatives

HMRC has launched a whole series of initiatives to crack down on tax evasion. They relate to:

- the rag trade
- the motor trade
- indoor and outdoor markets
- Scottish landlords

There are to be specific task forces to target areas of abuse - and people who HMRC consider are likely to break the rules.

There are also to be campaigns in respect of home improvement trades and e-market places and HMRC will be using new technology (I think this means Google) to identify areas where there may be taxable activity going undisclosed.

As usual, these campaigns will offer all those targeted the opportunity to come forward. This follows the recent announcement of the electricians campaign where HMRC are offering electricians "*a fresh start so they can stop worrying about what might happen when HMRC catch up with them*". Electricians who notify HMRC before 15 May and complete their disclosure by 14 August will have a limited penalty of between 10% and 20%.

There are differing views about the wisdom of all these initiatives, but as the effect must surely be to increase compliance both now and for the future, that must be a good thing. HMRC are naturally unsympathetic to people who have not dealt with their tax affairs properly and who do not take the opportunity to put matters right. Providing everybody has confidence that by making a disclosure they will be treated fairly in accordance with the statements then everything will be fine. This has certainly been my experience although I understand that this is not always the case.

Mansworth v Jelley : Losses

The decision In *Mansworth v Jelley* in 2003, of blessed memory, had extraordinary consequences which continue to reverberate. Where shares were acquired on the exercise of an employee share option prior to 10 April 2003, the employee was naturally treated as acquiring the shares at market value for CGT purposes, but the base cost was enhanced by the amount on which he paid income tax by reason of exercising the option. This would normally have been the same figure so the base cost of the shares for CGT purposes was therefore approximately double what might normally have been expected. These bizarre implications were explained in great detail by HMRC at the time in their press releases of January, March and August 2003.

This was all reversed by the Finance Act 2003 (causing all manner of other problems) but it did not

affect those who had banked huge losses on the basis of the extensive and very specific HMRC guidance on this matter.

In May 2009 HMRC issued a statement saying: Whoops - we were wrong. The base cost should not be augmented by the amount chargeable to income tax on the exercise of the option after all.

They could not reopen closed cases, or losses which had been claimed in tax returns or stand alone Schedule 1A claims which will protect losses brought forward (providing the enquiry window has closed), but open cases were going to be revisited.

HMRC has now decided to finalise all the outstanding cases and have issued a letter inviting anybody with an open claim to withdraw their claim to these losses. If you do not want to withdraw your claim, HMRC ask for an explanation why you believe your claim is valid. (This is an odd thing to say but in any event the answer should not be too difficult. How about "*I enclose copies of the following HMRC press releases on the subject*").

We know from the Gaines-Cooper litigation that HMRC are bound by their public statements and that taxpayers are entitled to rely on them. However, HMRC are quite entitled to change their views and to adopt a new interpretation, providing they do not seek to apply it retroactively to deny the rights of those to whom they have provided a legitimate expectation. I see a few difficulties over possible judicial review applications in these circumstances, particularly as they announced their new view in May 2009. The latest letter does not add anything to the argument but merely says that they want to bring these cases to a conclusion. There may not be too many left, but certainly some that do remain involve significant figures.

Dividends and NIC

In the August Tax Bulletin I mentioned the case of *P A Holdings Ltd v HMRC* where dividends were brought into charge to income tax and NIC in a rather controversial manner.

The position has not been improved by the more recent case of *Manthorpe Building Products Limited v HMRC TC 1778* where the Tribunal has considered similar issues, although the facts were rather different. The Tribunal was bound to follow the Court of Appeal decision in P A Holdings to the extent that it covered the same ground. However, an additional point arose in Manthorpe which may raise some eyebrows.

The Tribunal decided that the amount attributable to the employee was subject to PAYE and NIC but noted that there had been no grossing up. The company was merely charged to PAYE and NIC on the amounts of the bonuses and not the very much higher amount that would have been involved if the taxpayer had received a net amount equal to the bonus they actually received.

The Tribunal noted that the company may have a legal right to recover the PAYE and NIC from the individuals but had not done so. The Tribunal went on to say that:

> "*Unless HMRC is to advance the understandable but somewhat extraordinary contention that the appellants failure to seek to enforce the right [to recover the PAYE which should have been deducted] constitutes yet a further benefit of employment chargeable to tax. It would appear that our conclusion is right [that the taxpayers had gained a significant advantage]*".

I expect that most people will not find such a contention extraordinary at all - indeed what is extraordinary is that no grossing up had occurred. There may be good reasons why this was not done in this case, but I doubt that it will happen again.

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Wholly and Exclusively

Every now and again a case comes along which simply makes you smile. There may not be much precedential value - but you never know.

We all know that business expenses have to be laid out wholly and exclusively for the purposes of the trade and some interpretations of duality of purpose (e.g. *Mallalieu v Drummond*) are rather unsatisfactory. Nevertheless there is a very helpful passage in that case in which Lord Brightman says:

"*An expenditure may be made exclusively to serve the purposes of the business, but it may have a private advantage. The existence of that private advantage does not necessarily preclude the exclusivity of the business purposes. For example a medical consultant has a friend in the South of France who is also his patient. He flies to the South of France for a week, staying in the home of his friend and attending professionally on him. He seeks to recover the cost of his air fare. The question of fact will be whether the journey was undertaken solely to serve the purposes of the medical practice. This will be judged in the light of the taxpayer's object in making the journey. The question will be answered by considering whether the stay in the South of France was a reason, however subordinate, for undertaking the journey, or was not a reason but only the effect. If a week's stay on the Riviera was not an object of the consultant, if the consultant's only object was to attend on his patient, his stay on the Riviera was an unavoidable effect of the expenditure on the journey and the expenditure lies outside the prohibition in s 130*".

This has a resonance for the recent case of *Huhtala v HMRC TC 1775* in which an author decided to write a book about living on a boat. He claimed the expense of mooring and moving his boat to Port Grimaud and living there for a year. See what I mean - you have to smile.

However, he had the last laugh. The Tribunal did not allow him relief for everything, for reasons which are too obvious to explain, but he did get the cost of transporting the boat, the crane for putting it in the water and various other expenses.

Everybody knows how difficult it can be to get HMRC to agree to a deduction for expenses, so this case is worth a read to show what can be done.

Note: I am writing this from my yacht moored in the Maldives where I am researching a book on the super rich. It is a very complex matter and will take me some time. I will have to go to Gstaad next.

Reasonable Excuse

The Chartered Institute of Taxation, with impeccable timing, has published a note about penalties and what constitutes a reasonable excuse. This is a very helpful development because HMRC has been criticised a good deal in the Tribunals for their pursuit of penalties unfairly - and it is interesting to note the suggestion that HMRC are intending to be more flexible in interpreting the requirements for a reasonable excuse in the future. It is not said that HMRC have approved the CIOT statement, but anybody following the guidance is likely to have a very strong defence to any penalty.

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The CIOT statement refers to various parts of the HMRC Manual on the subject (SAM 61300) but regrettably makes no reference to the recent tribunal decision in Rowland SPC 548 where the failure of a professional adviser enabled the taxpayer to establish a reasonable excuse - contrary to the views set out in the HMRC Manuals.

In Buxton TC 1281 it was confirmed that the taxpayer is protected if he "*acts in the same way as someone who seriously intends to honour their tax liabilities and obligations would act*". This phrase does not appear in the CIOT statement; they adopt different wording viz : "*behaving as any reasonably responsible person would have done in the circumstances*" which I guess means the same thing.

With various filing deadlines having recently passed, this examination of the meaning of reasonable excuse is bound to come in handy.

FATCA

Anybody affected by the US Foreign Account Tax Compliance Act will be thrilled to know that the detailed regulations have now been published. The idea of FATCA is to enforce reporting, not to impose a charge to tax - but nevertheless there is to be a 30% withholding tax for those who do not comply with the reporting requirements.

It will also be of interest to know that the governments of France, Germany, Spain, Italy, the US and the UK have published an agreed approach to this legislation and information sharing. This will result in reciprocal information being provided by the US about US accounts held by residents of other countries. (I feel another disclosure opportunity coming on.)

An (almost) infinite amount of information on this subject is available on request.

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