UK Tax Bulletin

May 2012

Introduction

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Latest Rates of Inflation and Interest

The following are the current rates from May 2012

Current Rates	May 2012
Retail Price Index: April 2012	242.5
Inflation Rate: April 2012	3.5%
Indexation factor from March 1982: to April 1998 to March 2012 to April 2012	 1.047 2.031 (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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£2 million Properties: The Latest

The Treasury have now issued their proposals for the annual charge and capital gains tax charge on residential properties held by non-natural persons. These are designed to complement the 15% Stamp Duty Land Tax charge introduced in March in respect of transfers of residential properties worth more than £2 million to non-resident companies.

There has been considerable speculation and uncertainty about the Revenue's intentions concerning these two new charges and although the published details are merely consultation in advance of legislation coming into force next April, they show clearly what is intended.

Annual Charge

The annual charge will apply to residential property owned by non-natural persons if it is worth more than £2 million on a loan valuation date. The loan valuation date is to be 1 April 2012 and then subject to a revaluation every five years. The property valuations for this charge will be self-assessed by the persons liable to the charge.

As previously anticipated, this will be a completely new tax giving rise to an entirely separate charging regime. There will be a special annual charge tax return and HMRC will of course have conventional powers of enquiry.

The rates of tax for 2013-14 will be:

Property value:	£2m - £5m	£15,000
	£5m - £10m	£35,000
	£10m - £20m	£70,000
	Over £20m	£140,000

These figures will be indexed each year by reference to the Consumer Price Index.

The charge will be payable on 15 April in the year of charge - but the first annual charge tax return and payment will be 1 October 2013.

CGT charge

The capital gains tax charge for residential property held by non-natural persons is not a new charge but merely an extension of the existing capital gains tax.

At the moment, non-resident owners of UK assets such as residential property are outside the scope of capital gains tax and this general principle is not going to be undermined. Capital gains on UK residential properties held directly by non-resident individuals will not be taxable.

It is merely that the charge to capital gains tax is being extended to non-natural persons (which it is now clear will include non resident trustees) who dispose of residential properties in the UK worth more than £2 million. It is rather irritating that the definition of a non-natural person for this purpose is not the same as a non-natural person for the purposes of the 15% SDLT or the annual charge.

There are of course all sorts of detailed rules, but the above is the general framework and it would seem unlikely that there will be substantial changes as a result of the consultation.

As an aside, all those people who have been driven mad by being referred to by HMRC as *customers* (lots of whom I expect have signed the e-petition to persuade HMRC to go back to calling us *taxpayers*), will be horrified to find that this consultation paper now refers to us as "stakeholders".

IR35 Crackdown

The Treasury has issued a press release (HMT35/12) explaining that they are going to crack down on the Government engaging people "off payroll" in particular by use of personal service companies. (Interesting idea - the Treasury cracking down on the Government). Apparently over 2,400 key public sector "appointees" had been engaged in this way for more than 10 years. Confused? – I am not surprised - so is everybody else, because this is exactly what IR35 (introduced in 1999) and the subsequent managed service companies legislation in ITEPA 2003 were designed to prevent.

So I dare say that lots of advisors have had enquiries from clients and others saying why have you not advised me to do this. It cannot be because of IR35 or the managed service companies legislation as they obviously do not apply – the Government has been doing it for 10 years. You can see their point.

I am afraid I have no idea what is going on. IR35 and the relevant legislation make it quite clear that these rules apply where the relationship between the "employer" and the company or other intermediary supplying the services of the individual, would be an employment if it had been directly with the individual.

These arrangements were very popular for many years and I simply cannot understand how the cases which have received wide publicity involving the public sector could have been signed off as not falling within the IR35 rules. There must be facts relating to those engagements of which we are unaware.

The whole thing has become completely ridiculous. And of course the result will be more (and unnecessary) rules relating to appointments in central Government.

It is difficult to see that any tightening up is really necessary – all that needs to be done is for the existing rules to be applied which seem perfectly adequate to deal with the perceived abuse.

HMRC clearly could not resist the opportunity to extend the rules to the private sector so that all "controlling persons" will be treated as an employee of the engaging organisation - although mercifully these new rules are not intended to apply to businesses with fewer than 10 employees or assets of less than £2 million.

What is a "controlling person"? HMRC have published a consultation paper on the point. 19 pages to explain that it will mean a person who is able to shape the direction of the organisation having responsibility or authority in directing or controlling the major activities of the organisation and who has managerial control over the employees or the budget of the organisation. The cases when such a person will not be an employee must be very rare.

IR35: Checklist

It gets worse. HMRC has issued a checklist of tests to help you decide whether the IR35 rules apply and PAYE should be applied to somebody you might engage to do work for you. The tests have various degrees of importance and are given points which you add up to see whether the engagement is low, medium or high risk of attack under IR35. Obviously this is important because this is the basis HMRC will use to decide whether they will commence an enquiry.

It is too tedious to go through all the 12 tests particularly as they suffer from regrettable lack of balance. I would simply observe that for example if you engage a concert pianist to play at a concert you would think that there is pretty low risk of him being treated as your employee. Wrong. If you go through these tests and count up the points you will find him firmly in the high risk category – which casts rather serious doubt on the whole thing.

Losses: Mansworth v Jelley

Things are moving along on this subject. Just to recap, when shares were acquired by an employee on the exercise of a share option, he usually had to pay income tax on the value of the shares. For the purposes of capital gains tax he was naturally treated as having acquired the shares at that value.

However, in 2003 the case of Mansworth v Jelley determined that the capital gains tax base cost was enhanced (absurdly) by the amount upon which he had paid income tax by reason of exercising the option. This was usually the same figure so the base cost of the shares for CGT purposes was approximately double that which it should have been.

This was obviously unintended but the position was clear and HMRC published extensive guidance on the matter explaining the background reasoning. They also caused the rules to be changed by the Finance Act 2003 although that did not affect all those who had banked huge losses by reason of this decision.

It all went quiet until May 2009 when HMRC issued a statement saying that their previous view was all wrong. The base cost should not be augmented by the amount chargeable to income tax after all. They could not reopen closed cases but open cases were going to be revisited.

Accordingly, earlier this year HMRC wrote to those with an open claim inviting them to withdraw their claim to these losses. Strangely, they said that if you do not want to withdraw your claim, you need to explain why you believe your claim is valid. I imagine that most people would have replied pointing to the specific guidance published by HMRC at the time.

I understand that this has caused a degree of dissatisfaction because having been provided with the requested explanation, HMRC simply rejected them all out of hand.

In many cases, the denial of these losses would not be susceptible to an appeal to the Tax Tribunal and the taxpayers only remedy would be an application for judicial review.

Concern had been expressed that the rejection from HMRC might be regarded as "decisions" thereby starting the time running for the purposes of an application for judicial review. As the time limit for making a claim is only 3 months, this clearly assumed real significance.

However, the CIOT have received confirmation from HMRC that their letters on this matter will not be regarded as decisions for the purposes of the time limit for judicial review. HMRC will be making decisions in each case according to the individual circumstances and time will not start to run until that occurs.

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Penalties: Offshore matters

HMRC have published a fact sheet explaining the higher penalties which will be charged for income tax and capital gains tax where an offshore matter is involved. This seriously increases the risk for anybody unwise enough to conceal income or gains abroad.

An offshore matter for this purpose includes income arising or assets held outside the UK or activities carried on outside the UK which are taxable here.

The penalty will be dependent upon the relevant offshore location – a maximum of 100% of the tax where there is an automatic exchange of information agreement with HMRC; 150% where the exchange of information is not automatic and 200% where there is no agreement with that territory to share information.

The amount of the penalties will also depend upon whether the taxpayer's inaccuracies or failures to notify are careless, deliberate or concealed and whether the disclosure to HMRC is prompted or unprompted. There is a complicated matrix to determine the estimated penalty to take into account all these factors.

It is interesting to note that HMRC suggest that an unprompted but careless inaccuracy in a tax return relating to offshore income and gains will give rise to a penalty between 0% and 45%. I can well imagine circumstances where inaccuracies occur and the taxpayer should not be penalised – but I am struggling to think of circumstances when HMRC would not charge any penalty where there had been a careless inaccuracy. It is good (and valuable) to know that HMRC recognise the possibility.

Eclipse 35: Trading

The First Tier Tax Tribunal has recently found against the taxpayer in the case of Eclipse Film Partners No 35 LLP thereby disallowing the claims to tax reliefs by the partners in the LLP. The facts are special and complicated and I mention the case only because of the comments about what constitutes trading. This was significant in the case because it was the finding that the LLP was not trading which made all the difference to the claim.

Whether a trade is being carried on is a matter of almost proverbial uncertainty and it naturally depends upon the facts and on the intentions of the taxpayer. We do of course have the celebrated guidance in the form of the badges of trade but the Tribunal in Eclipse 35 had a few ideas of its own. In particular, they suggested that speculation was necessary for a trade to exist.

This is an interesting development because speculation is not one of the badges of trade and although it may be a very relevant factor, it is a surprise to find that this is so important that it overrides all the other badges of trade. The Tribunal also made a great deal of the absence of any discernible customer - a factor derived from the House of Lords decision in *Ransom v Higgs*. I think the most important thing here is that the long established badges of trade, the hallmarks of a trade for decades, may not have been afforded the respect and authority they deserve. Some may think that the Tribunal went a bit too far.

However, maybe all that has happened is that we have some more badges to take into account - and that some are more important than others.

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Residence: HMRC6 - Full Time Work Abroad

It may be remembered from earlier bulletins that where a person leaves the UK to work full time abroad they will be treated as non-resident (even if they had not made a distinct break), providing they are leaving to work abroad under a contract of employment for at least a whole tax year and their visits to the UK will be less than 91 days a year on average.

There is a trap here if you leave the UK for this purpose towards the end of the tax year. If for example, you leave the UK on 31 March to work in (say) Geneva but you spend a couple of weeks seeing the sights and organising your paperwork and finding a flat etc and do not start work until 12 April, HMRC will not accept that you have become non-resident; your full time employment will not have started at the beginning of the tax year, so you would not have been working abroad for the whole tax year. So it is very important not to have a holiday before starting your new job if that is likely to cross the tax year. It would be much better to start the new job first and then have the holiday.

This point has apparently been raised with HMRC who said that HMRC 6 provides clear guidance on the situation where any individual takes an overseas holiday before becoming non-resident. I think they are right. Their guidance in HMRC 6 is very clear - in confirming that this is exactly the position. It says that you will only become non-resident as long as "you have actually physically left the UK to begin your employment abroad and not for example to have a holiday until you begin your employment".

This remains a trap for the unwary but apparently HMRC have been persuaded to review their guidance. We will see whether this results in any sympathy to employees in these circumstances.

New Task Forces

HMRC announce that they have "unleashed" six new task forces. They are going after market traders in London, taxi firms in Yorkshire and the East Midlands, property rentals in East Anglia, London, Yorkshire and the North East, and restaurants in the Midlands.

These task forces are specialist teams that undertake "intensive bursts of activity" in specific high risk trade sectors and locations in the UK.

I am not sure about all this hyperbole - but never mind. I expect that restaurateurs in the Midlands will wonder why they have been singled out as being a specific high risk sector and location - but taxi firms in the West Midlands are OK. (A Freedom of Information request would be interesting).

This, and the frequent insistence that people (other people of course) pay "the right amount" of tax is a bit unnerving. This seems to be the amount of tax that whoever is doing the insisting thinks is right - whether he is informed or otherwise. Fortunately, HMRC do understand that legal authority is required to collect tax - not personal opinions and slogans.

These new groups of taxpayers may well feel that they are being unfairly tarred with an unspecific brush and will want to draw HMRC's attention to the taxpayers' charter in which it is acknowledged that the taxpayer will be assumed to be truthful unless there is some good reason to believe otherwise.

Indeed they might need to say something more robust if they find themselves on the end of an enquiry based not on evidence but on some general assumptions about other people.

Remittance for Investment

HMRC have published a guidance note on the changes to the remittance basis relating to the new business investment relief - that is the ability for resident non-doms to remit foreign income and gains for the purposes of making a qualifying investment in a UK business.

The note does not contain anything particularly new but is helpful additional guidance on the operation of this valuable relief. But oh my word, they do make it complicated. I need not set out the details again but the general idea is that you can bring in foreign income or gains to invest in a qualifying business in the UK without it being treated as a remittance. However, if you dispose of the investment, or if the proposed investments aborts you have to take the money out again within 45 days.

There are many helpful examples including some on the more complex position where you make an investment in a UK business in which you already have an interest. In that case, any disinvestment is treated as taking place on a last in first out basis. However, if you make multiple investments of income or gains, any disposal will be regarded on a first in, first out basis. Don't ask.

It has also been clarified by HMRC that the use of foreign funds in this way will not give rise to a taxable remittance on the grounds that the company is a relevant person. This is because the way the relief operates, the investment as not treated as a remittance of the foreign income or gains so the fact that the funds are used by a relevant person does not matter.

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