UK Tax Bulletin

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Latest Rates of Inflation and Interest

The following are the current rates at July 2012

Current Rates	July 2012
Retail Price Index: June 2012	241.8
Inflation Rate: June 2012	2.8%
Indexation factor from March 1982: to April 1998 to May 2012 to June 2012	 1.047 2.051 (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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EU Tax Exemption

The recent case of *Bourges-Maunoury (Case C-558/10)* seems to have some real possibilities. The issue here was that the taxpayers (well actually, the non taxpayers) were employed by the EU and received earnings and pensions as a result of that employment. They were resident in France and in principle liable to wealth tax. The French tax authorities regarded the funds derived from their employment with the EU as part of their wealth for wealth tax purposes and this was upheld by the French Courts.

However, the European Court have now declared that member states are prohibited from imposing any taxation whatsoever which is based wholly or partly on the payment of salary to the official by the EU.

We do not have any wealth tax in the UK but we do have other things like inheritance tax and it is not difficult to conclude that funds which can be traced to the earnings from an EU employment, cannot have any UK taxes imposed upon them.

Indeed, I do not see why the purchase of a UK residential property by a company funded entirely by identifiable EU earnings cannot be regarded similarly – and maybe this is an opportunity for such persons to escape the proposed annual charge.

I am tempted to wonder whether it is morally repugnant to be employed by the EU if by doing so, all taxes on the income are avoided.

France and Trusts

I have been reading some worrying reports of some new rules in France relating to the disclosure of trusts where the settlor or any of the beneficiaries are resident in France or if a trust asset is situated in France. It is suggested that disclosure of the trust and the trust assets must be made to the French tax authorities by 15 September 2012. It seems that these obligations apply equally to foreign trusts.

I understand that unless the assets are already subject to wealth tax on the settlor or beneficiaries there will be a charge of 0.5% of the trust assets situated in France.

I think there will be many people who will be concerned about this - obviously any French resident who is the settlor or a beneficiary of a trust, but also anybody who has a French asset, for example a house or shares in a French company or even a bank account in France, which is owned by a trust.

I know nothing about French tax but from an English perspective this raises a mountain of questions - like what do they mean by a settlor? Is it the named person or someone who provides value to an existing trust - and what about adding value to a company owned by a trust, and so on. And how is the settlor supposed to know the details of the trust property - or where it is situated. I would particularly like to know who counts as a beneficiary - is it those specifically named or does it include people who the trustees have power to add. It would be delicious to include President Hollande as a discretionary beneficiary.

We may get clarification soon, but as the notification needs to be made by 15 September on pain of a minimum penalty of €10,000, this may be a matter deserving some consideration.

Remittance Basis

The remittance basis causes an increasing amount of headaches – but the Tribunal case of *Klaus Otto Pflum TC 2051* explores an interesting area. Mr Pflum and his girlfriend (later his wife) were resident in the UK and they had a joint bank account outside the UK. Mr Pflum's foreign earnings subject to the remittance basis were transferred to the joint account and Mrs Pflum accessed this account using a debit card in the UK. HMRC suggested that all the sums in the account were beneficially owned by Mr Pflum as they represented deposits of his earnings and therefore all monies withdrawn in cash in the UK or used to pay for goods in the UK represented remittances of those earnings which were therefore subject to tax.

Mr Pflum said that the amounts withdrawn by his wife were beneficially owned by her and the amounts enjoyed in the UK by her by the use of the cards were not remittances by Mr Pflum.

The issue centered on the correct legal analysis of a joint account.

HMRC suggested that the account was a joint tenancy and when monies were remitted to the UK they were to be regarded as remittances by Mr Pflum as one of the joint holders of the account. The Tribunal said that this was wrong. The essence of joint ownership of a bank account where withdrawals can be made without restriction by either party, is that sums belong to the party who withdraws them. When Mrs Pflum used the debit card in the UK what was being remitted to the UK were funds solely owned by her and there was no remittance by Mr Pflum.

Withdrawals were made by Mrs Pflum without reference to Mr Pflum and any cash so withdrawn would be her own money as she was drawing on an asset which was just as much hers as it was Mr Pflum's. The Tribunal rejected HMRC's suggestion that because the monies derived from Mr Pflum he was to be regarded as not having alienated them, in the absence of clear evidence of severance of the joint tenancy, to confer beneficial ownership on Mrs Pflum.

Whilst this is a very interesting case on the treatment of joint bank accounts, it does not have any application to the position after 5 April 2008 if the other joint holder is a relevant person. Without wanting to enquire too deeply into their personal affairs, while Mr Pflum and his girlfriend were unmarried she would not have been a relevant person unless they were living together as husband and wife. I do not know what this is supposed to mean. What is it that distinguishes a man and a woman who are living together from a man and a woman who are living together as husband and wife? I wonder whether it is too simple to say that before they were married they were not living together as husband and wife – and after they were married, they were.

Loans to Participators

The Tribunal recently had occasion to consider whether a loan had been made to a participator within the meaning of Section 419 Taxes Act 1988 (now Section 455 Corporation Tax Act 2010) : *Aspect Capital Limited v HMRC TC 2112*.

The issue was whether an employee acquiring shares in the company under a facility provided by a third party and discharged by the company, was in receipt of a loan from the company. HMRC said this was a loan by the company to the employee and Section 419 therefore applied giving rise to a 25% charge on the amount of the loan.

The taxpayer said that there was no loan. The discharge by the company of the employees liability to the third party did not amount to a loan. There is clear House of Lords authority to that effect from *Potts Executors v IRC (1950)*.

The Tribunal analysed the position fully and concluded that there was a loan. This seems unnecessarily controversial because they did not need to go that far; Section 419(2) provides an extended meaning of a loan for this purpose where the employee "incurs a debt" to the company and there seems little doubt that there was a debt between the employee and the company even though it arose via a third party.

However, although the outcome should perhaps never have been in doubt the taxpayer could perhaps be forgiven for feeling a bit paranoid when you consider that:

a) the Tribunal disregarded clear House of Lords authority on the point;

b) the Tribunal ignored the fact that another Tribunal had come to the opposite conclusion in the recent case of *MJP Media (2010)*; and

c) in *MJP Media* HMRC had argued exactly the opposite.

The taxpayer may find all this a bit hard to swallow. However, for the rest of us, there is something extremely worrying if HMRC are able to advance completely opposite arguments in identical cases and succeed on both.

Reasonable Excuse

The Tax Tribunal has recently had to consider the requirements for a reasonable excuse in connection with a surcharge for late payment of tax: *Holly Chichester v HMRC TC 2081*.

The Tribunal said that the well established jurisprudence is that an honest belief in a state of affairs can (and usually will) amount to a reasonable excuse. However, the issue was one of whether the honest and reasonable belief was to be determined subjectively or objectively. There is authority from *Intelligent Management UK Limited v HMRC (2011)* that there must be some reasonable basis for the honest and genuine belief - an irrational or unreasonable belief even if honest and genuine, would not be enough.

However, in the case of *Holly Chichester*, the Tribunal rejected this approach saying that the matter is purely subjective and the objective analysis was simply a matter of credibility - that is to say whether the person did in fact hold the honest belief that they claimed. The Tribunal said in the clearest possible terms:

"*If a Tribunal finds that a person, as a matter of fact, held a particular honest and genuine belief, that may amount to a reasonable excuse (on appropriate facts) regardless of whether that belief would be characterised as irrational or unreasonable when viewed objectively.*"

This does seem uncommonly generous to me. After all we are looking here at a "reasonable" excuse and although an irrational and unreasonable (but honest) belief may well be an excuse, I would have thought that the requirement for the excuse to be "reasonable" imports a measure of objectivity into the determination. It does seem to be instinctively wrong for unreasonable and irrational behaviour to afford a defence.

In any event, this formulation seems to be intrinsically flawed. If the objective analysis goes solely to the issue of credibility - did the person really have an honest belief to that effect - whether you believe them or not will be based on an objective assessment of whether they could possibly have held that view. It is really saying that the belief cannot be so unreasonable or irrational that it could not objectively be the basis of the taxpayers belief.

Who knows whether HMRC will take this one further but it is very unsatisfactory that there are so many conflicting reasonable excuse cases. An aggrieved taxpayer really has no means of assessing the likely success or failure of an appeal. This uncertainty is not improved by *Holly Chichester* and that is only going to multiply the number of reasonable excuse claims.

With the enormous backlog of Tribunal cases, this is the last thing we want. However, we could also do without cases which should never be brought by HMRC in the first place – such as *Nataliya Geyko-Bisson TC2083*. Mrs Geyko-Bisson sent in her 2009/10 tax return late. HMRC imposed a penalty of £100 despite the fact that the additional tax liability was only £15.80. Section 93(7) Taxes Management Act 1970 provided that a penalty would not exceed the amount of tax that would have been paid had the tax return been submitted on time. There seemed to be no dispute that the relevant tax would have been £15.80 and unsurprisingly, the Tribunal reduced the penalty to that amount. How or why this case ever reached the Tribunal is a mystery.

Inheritance Tax : Penalties

Malcolm Gunn writes:

HMRC proposes to harmonise the penalty regime across all taxes including inheritance tax although not all the IHT provisions have yet come into force. But when they are, the IHT tax penalties will be a lot worse than they are at the moment, and those who are late making IHT returns or who make careless errors will have an unpleasant shock . Remember that with penalties, and all the more so in relation to IHT, the client may not see them as his responsibility at all.

The penalties for inheritance tax which have already been introduced are:

1. Errors in returns due to carelessness: 30% penalty which may be reduced to nil for unprompted disclosure or 15% for prompted disclosure.

2. Errors in returns due to deliberate but not concealed conduct: 70% penalty which may be reduced to 20% for unprompted disclosure and 35% for prompted disclosure.

3. Failure to point out a mistake by HMRC in an inheritance tax account: penalty 30% of potential lost revenue.

4. Giving false information to, or withholding information from, another person who is liable to make an IHT return: penalty 100% of the potential lost revenue.

There are also very significant penalties for deliberate and concealed conduct leading to mis-declarations. With other errors, HMRC will undoubtedly be quick to suggest that there has been carelessness and in relation to the size of liabilities which commonly arise with inheritance tax, it will be appreciated that penalties could easily be substantial. This has rightly caused some trepidation, with the result that in its latest capital taxes newsletter, HMRC confirm that there is no need to notify HMRC every time there is an amendment to the initial IHT calculation provided that changes do not amount to more than £50,000 and do not relate to land or unquoted shares. Notification will be satisfactory 18 months from the date of death or at the point the estate is finalised, unless the case is subject to a compliance check when errors should be notified immediately.

The penalties for failure to make a return are yet to be brought into effect. At present the maximum penalty is £3,000 but this will increase to 70% of the tax due on the return in deliberate but not concealed cases if a return is over one year late. There is a defence of reasonable excuse, but we all know how narrowly HMRC interprets that exception. A penalty is also likely for late payment of inheritance tax, similar to self assessment surcharges, so things are definitely hotting up for those handling inheritance tax returns.

FURBS and NIC

The debate about whether contributions to a FURBS are subject to NIC continues. The Court of Appeal has decided that they are, overturning the High Court decision in *HMRC v Forde and McHugh Limited* – and at the same time deciding that the case of *Tullett and Tokyo Forex International Limited (2000)* was also wrongly decided.

In this case, assets were contributed to a FURBS and the question was whether this contribution was subject to NIC. The key issue was whether the meaning of “earnings” for NIC purposes was wider than “emoluments” for the purposes of income tax.

The Court of Appeal decided that there was no direct link between the two terms and they should be considered separately. Earnings did have a wider meaning than emoluments and encompassed a contingent entitlement such as this contribution to a FURBS.

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It has long been argued that these terms did not mean the same – and although that is extremely unsatisfactory, it is at least helpful to have it confirmed that they are not synonymous. However, it would have been useful to have some clarity about what they mean. Saying that earnings for NIC purposes is able to extend to contingent entitlements to benefits is all very well, but it would be helpful to have a definition of both rather than examples of what they might contain. At the moment we have two terms with no clear distinction between them or indeed any real clarity about what they mean.

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