UK Tax Bulletin

October 2012

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Latest Rates of Inflation and Interest

The following are the current rates at October 2012

Current Rates	October 2012
Retail Price Index: September 2012	244.2
Inflation Rate: Septemer 2012	2.6%
Indexation factor from March 1982:	
to April 1998	1.047
to August 2012	2.059
to September 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%

Deductible Expenditure

Those with an interest in Formula 1 will remember that a little while ago some confidential documents relating to Ferrari were found in the possession of an employee of McLaren. The FIA decided that there had been some impropriety and imposed a substantial fine on McLaren of approximately £32 million. The question was of course whether this £32 million was an expense wholly and exclusively laid out for the purposes of the McLaren trade.

HMRC said it was not. They said that the penalty arose from conduct outside the trade. Legitimate gathering of information was part of the trade but illicit gathering of information was not. The penalty was for improper conduct of McLaren's employees and a punishment for a serious breach of the rules.

The Tribunal did not feel that any of these things were not for the purposes of McLaren's trade. They went so far as to say that the profit making activity carried on by McLaren was not limited to acting within the confines of its contractual agreements and could include cheating.

The penalty was a commercial penalty designed to affect McLaren in its commercial activity. It was not like a statutory penalty designed to be suffered by an individual. Furthermore, the penalty was not levied for the protection of the public but mainly for the regulation of a commercial activity. The penalty was something which arose from its trade, was connected with its trade and was incurred wholly and exclusively for the purposes of the trade.

The two Tribunal judges came to different conclusions and the dissenting view was that the payment was not laid out wholly and exclusively for the purposes of the trade and/or it was a loss not connected with or arising out of the trade. It was imposed because the conduct of McLaren fell way outside any normal and acceptable way of conducting their trade. Furthermore, if McLaren were seeking to preserve the whole structure of their profit making apparatus, it could be argued that the payment was capital. However, the dissenting view was overruled by the Chairman who had the casting vote and the £32 million was allowed.

Strong views have been expressed about this decision and instinctively it seems somehow wrong that conduct so wrongful and serious that it merited a £32 million fine should be entitled to a tax deduction. It is also perhaps a little extreme for Judge Hellier to suggest that fraud and deceit as well as cheating were part of McLaren's trade.

However, I wonder whether the arguments here are distorted by the enormity of the figures and the particular circumstances. We are dealing here with a commercial contract between a number of substantial commercial bodies and the documents in possession of McLaren really only gave rise to impropriety because they were prohibited by the contract. If the contract had provided for a full disclosure of technical data between all Formula 1 teams, there would have been no issue. Accordingly, we are simply looking at one party to a commercial contract acting in breach of that contract and the other parties insisting on a particular sanction. The size should not matter.

Many commercial contracts contain penalty clauses, for example for failure to meet certain performance or delivery targets, and these are all in the nature of punishments for failing to meet the agreed terms – or otherwise to encourage prompt performance. A person is still carrying on his trade even if in the course of that trade he does not necessarily adhere to every term of every contract he has entered into. He does not cease to be trading just because, for example, he fails to deliver his product on time.

There is considerable authority for the proposition that a penalty for a breach of the law cannot be allowed as a matter of policy, but we are not dealing with that here. Although there are some surprising elements in this decision, the conclusion to allow relief for this payment would not seem to be in conflict with existing authority nor able to be dismissed on policy grounds.

Reasonable Excuse

There are so many reasonable excuse cases these days that you barely know where you are. One recurring theme is when a default occurs by reason of the failure of a professional adviser. It is now clear beyond doubt that the important question is whether the taxpayer himself was negligent. He cannot be principally or vicariously liable for the negligence of his professional adviser. The taxpayer is not expected to second guess his professional adviser unless the advice was obviously suspect and that the taxpayer deliberately closed his eyes to what was, or ought reasonably to have been seen as, incorrect advice. In those circumstances, it would not be the advisers negligence being imputed to the taxpayer but his own negligence in relying unreasonably on doubtful advice. This was the substance of the decision in *Waseem Shakoor TC 2208* to which reference was made last month.

In *Lithgow v HMRC TC 2296* the Tribunal tried to reconcile some of the cases. They explained the circumstances where the taxpayer is protected, and where he is not, when relying on a professional adviser.

The Tribunal drew a distinction between those circumstances where the adviser acts in an advisory capacity (for example in advising on the availability of a relief or exemption), and where the adviser acts as an administrator or functionary (such as filing a document or making a claim within a time limit). The taxpayer is entitled to rely on the advice of the expert professional adviser unless there is reason to believe to the contrary. However, where the adviser merely acts as a functionary in filing a return or undertaking some other administrative task, the negligence of the adviser will not usually provide a defence to a penalty.

However, that is not to say the taxpayer would be left without any remedies. The failure to file a return or meet a deadline by the negligence of the adviser may not provide a defence to a penalty imposed by HMRC - but it is likely to give him grounds for recourse against the negligent adviser.

Entrepreneurs Relief

The recent case of *Russell v HMRC TC 2299* concerned a claim to entrepreneurs relief in respect of a disposal of farmland.

Three brothers carried on a farming business and in 2009 they disposed of 35% of the farmland at a substantial capital gain.

At first sight the claim to entrepreneurs relief looked hopeless. There is no doubt that the land was used for farming, but entitlement to entrepreneurs relief requires the disposal of the whole or part of a

business. This was simply the disposal of part of the land. *McGregor v Adcock 1977 STC 206* is good authority that the mere sale of the farmland is not a disposal of part of the farm business.

However, Mr Russell felt that the application of these general principles was inappropriate in his circumstances. The farm comprised of approximately 22 hectares of barley. That was the business and his job as farmer was to look after the business. The sale of 7 hectares meant that 35% of his business was gone so why should it not be said that the sale of the 7 hectares was not a sale of part of the business.

The Tribunal, taking their lead from *McGregor v Adcock* looked at the nature and extent of the business activities before and after and concluded that Mr Russell ran the business in exactly the same way both before and after the sale. That does not seem to be in the least surprising - and indeed must be inevitable if you are selling part of the business. Why should you conduct the remaining part of the business any differently from the way you conducted the whole? The more important element should surely be the extent of the activities after the sale - and in this case his activities were clearly scaled down to reflect the fact that the business was rather smaller than it was before.

That sounds good - but not good enough. In *Atkinson v Dancer* it was said that where a farmer sells some land which he has been using for a farming business, that will not prima face amount to the sale of part of the farming business because it is not in itself the sale of any part of the business notwithstanding that the sale of the land on which the business has been conducted will reduce the activity of the farmer and probably his profits.

This is very powerful authority but possibly too broad an explanation to deal with Mr Russell's circumstances. It is clear that in the context of a dairy farm, the sale of a field or the sale of a barn (or in a manufacturing company the sale of a factory with the processes being transferred to other premises) would represent the mere sale of an asset without the disposal of any part of the business. But Mr Russell's business was cultivating barley on a 22 hectare field. That was the whole of his business so one might enquire what he would have to do in order to sell part of his business?

Maybe the crop had been harvested and the land was just bare land, the sale of part of it might not represent part of a business. But what if he sold 35% of the land (including the growing barley) to another farmer who continued to farm it in the same way? Why should that not be the sale of part of the business? And how about the position when new barley has just been sown? Should it really make a difference whether the land is sold immediately before or after sowing or harvesting?

One might reasonably expect the legislation to be capable of applying to these simplest of circumstances and perhaps the judgments in *Atkinson v Dancer* and *McGregor v Adcock* were applied too literally to Mr Russell's circumstances. Otherwise it would seem to be impossible for Mr Russell to dispose of part of his business and that would be a harsh and possibly unreasonable interpretation. Why should the legislation not be interpreted purposively so that some effect can be given to it, rather than for purposive interpretations only to apply against the taxpayer.

Benefits in Kind : NIC

An interesting debate took place in *Marcia Willett Limited v HMRC TC 2301* relating to the application to a charge to NIC on benefits in kind in circumstances where there is no charge to income tax.

The company provided benefits to the directors but the benefits were made good by the taxpayer and Section 203(2) ITEPA 2003 applied to eliminate any change to income tax.

That is hardly unusual – so one might wonder what the problem was. It was because HMRC took the view that benefits in kind also give rise to Class 1A NIC but there is nothing in the NIC legislation which refers to making good, so irrespective of the income tax position, the Class 1A contributions remained payable.

The Tribunal concluded that there can be no charge to Class 1A NIC where there is no income tax charge. They dismissed HMRC's arguments saying that they offended the principles of statutory interpretation. (Others might suggest that it offended against common sense and fairness as well.)

HMRC said that NIC refunds cannot be made when a subsequent event occurs which may alter the amount on which NIC is originally assessed. The Tribunal did not see why this should be the case. They observed that the general structure of UK tax legislation is that a tax liability can be affected by future events; losses can be carried back to an earlier period, tax returns can be kept open for 12 months or longer and HMRC can amend tax returns on the basis of facts discovered after the event.

The Tribunal decided that the making good by the taxpayer meant there could be no chargeable benefit to which a charge to NIC could be imposed.

There was more in this case than a simple criticism of an unfair approach by HMRC. The issues surrounding "making good" were interesting. The benefits provided by the company to the directors had been made in the years 2002 to 2007 but it was only on 6 May 2008 that the directors made good the benefit by an adjustment to their directors loan accounts. There was no dispute that this had the effect of removing the income tax charge for each of the relevant periods.

The Employment Income Manual sets out the view of HMRC on this subject as under:

> "*The legislation does not set a time limit on the making good. This will usually happen shortly after the expense is incurred by the person providing the benefit. But you need not object to a belated making good if it is done within a reasonable time of the employee becoming aware that the chargeable benefit can be reduced in whole or in part by reimbursing the expense incurred by the provider. What constitutes a reasonable time will depend on the facts of the case. Do not allow a decision for making good which takes place after a charge to tax on the benefit concerned has become final and conclusive.*"

In the case of *Marcia Willett*, it must obviously have been the case that these conditions were satisfied but it shows just how long you might have to make good a benefit under Section 203.

Unfortunately, this will not always be the case. Completely different rules apply to earnings which arise from "notional payments" (such as payments by intermediaries, readily convertible assets or restricted securities) where there is a PAYE deduction obligation on the employer. This can be eliminated by the employee making good the relevant amount – but the making good has to be effected within 90 days (Section 222 ITEPA 2003). And just to be helpful, HMRC adopt a different interpretation for "making good" for this purpose.

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Penalties

The Upper Tribunal have just released their decision in the case of *Hok [2012] UKUT 363*. It may be remembered that Hok Limited was late in paying its PAYE and became liable to a penalty. The First Tier Tribunal said that HMRC acted neithery fairly nor in good conscience in deliberately waiting until 4 months had passed before issuing a penalty notice by which time the penalty had multiplied from £100 to £400. The penalties were quashed on the grounds that HMRC fell very far below the standards of fair dealing and conscionable conduct to be expected of an organ of the State.

The Upper Tribunal have allowed the appeal by HMRC essentially on the grounds that the penalty was properly due under the law and the First Tier Tribunal had no power to quash it – they were assuming a judicial review function which was beyond their authority.

I am sure they are right – but there is something very wrong here. Surely HMRC cannot say that the penalty was clearly prescribed by statute and even if their conduct was unfair there is nothing anybody can do about it. Similarly it must be right to say that Parliament knew what it was doing when it passed the legislation and that it intended to leave supervision and conduct of these penalties to HMRC. However, it cannot seriously be suggested that Parliament intended HMRC to apply the legislation in an unfair and unconscionable manner.

Surely somebody in appropriate authority must understand that when the Courts describe HMRC's conduct as unfair and unconscionable this is seriously damaging to their reputation and the prospect of compliance by the majority of taxpayers. For HMRC to say that they do not recognize that they acted in this way – and worse to say even if they did, it doesn't matter – makes the position incalculably worse.

We are not dealing here with some dodgy scheme by some rich, fat cat, banker or foreign person (I am going for the full set of perjorative characteristics here) trying to get out of paying their fair share of tax, just someone who was late in making their PAYE payments.

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26 October 2012

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