UK Tax Bulletin

November 2012

SQUIRE SANDERS

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Latest Rates of Inflation and Interest

The following are the current rates at November 2012

Current Rates	November 2012
Retail Price Index: October 2012	245.6
Inflation Rate: October 2012	3.2%
Indexation factor from March 1982:	
to April 1998	1.047
to September 2012	2.074
to October 2012	2.092

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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Pre Budget Report

Next Wednesday, the Chancellor will give his pre Budget Report and this will be followed by the issue of a draft Finance Bill. Sounds like a real Budget to me - and I dare say we will be blessed with 500 pages of explanatory press releases. This might encourage me to issue a special Budget Bulletin - we shall see.

I expect we will get more details about the new charges on £2 million residential properties, and maybe final clarification over the outstanding issues on the Statutory Residence Test. There will probably be one or two other things as well.

I doubt whether anything will really change. The Chancellor needs more money. But he cannot get it from the lower paid - obviously. He cannot get more from the rich (there are not enough of them and anyway even HMRC agree that he is beyond the scale on the Laffer curve to get more money: the only way to raise more money from the rich is to reduce taxes - but he cannot do that). So he has to get it from everybody else in the middle ground. But they will protest too much (and they are voters) so he cannot do that either. So if in reality, he cannot get any more money, all he can do is to bash the rich and pretend it will do some good.

Swiss Cooperation Agreement

It is announced that the agreement with Switzerland will be coming into force on 1 January 2013. Things will therefore be getting a bit tense for anybody who has funds in Switzerland which should have been disclosed to HMRC.

HMRC are urging everybody to come clean and their guidance note on the subject is engagingly simple : if you do nothing, on 31 May 2013 a one off payment (anything between 21% and 41%) will be taken from your Swiss assets. No pressure then. It does not end there, because future income and gains will be subject to a swingeing withholding tax each year.

Those who make a full disclosure of their income and gains to HMRC will not be affected at all.

Foreign domiciled individuals resident in the UK may only be liable to UK tax on their Swiss income and gains if they are remitted to the UK and a more limited disclosure applies to them.

In addition UK resident beneficiaries of discretionary trusts or foundations are excluded from the definition of a “relevant person”. It is interesting that although the LDF made specific provision to bring the settlor within the scope of the disclosure requirement by deeming the settlor to be the beneficial owner, there is no similar provision in the Swiss agreement.

I imagine that anybody who has hidden funds in Switzerland will find it increasingly difficult to obtain professional assistance having regard to the obligations on UK professional advisers in this area, except of course to accept instructions to make a full disclosure to HMRC.

Where Swiss funds have not been properly disclosed to HMRC, there will be penalties of course but a disclosure now will be more sympathetically considered by HMRC. If you can get inside the LDF, that could prove to be the best option as it limits the penalty to 10% for the 10 years up to 2009 and 20% thereafter.

Tax on Multi National Businesses

I imagine that there may be some frustration among tax professionals about the media interest presently given to tax issues. Accuracy, and indeed common sense have been early casualties in the pursuit of headlines by politicians (and the media) on tax issues.

There have been many claims about the fact that various multi-national companies did not pay much tax last year with the clear implication that they have been involved in some dodgy tax arrangements which have relieved them unfairly from their tax obligations or that they have done something else which is equally morally repugnant. The possibility that in these difficult times, the company might have made significant losses which have not yet been fully recovered, or has continuing and substantial capital expenditure are factors which do not even get onto the radar. Furthermore, a multi-national, by its very nature, operates in various parts of the world and may make profit in other countries. However, it is simply assumed that if they operate in the countries which charge lower taxes, the operations there must be all part of some overall plan to deprive the UK tax authority of their entitlement.

Anybody would think that we do not have any transfer pricing legislation or that HMRC are completely unaware of the tax saving possibilities of transfer pricing (which the journalists naturally understand fully). That is both ill-informed and insulting.

Most companies do their very best to obey the law when dealing with their tax affairs. However, others who use deception and concealment in their tax affairs are not seeking to obey the law – they are trying to break it and they should be vigorously condemned and pursued. But it is very important to understand the difference – if lawful conduct is not to be distinguished from unlawful conduct, we are not safe in our beds.

It is therefore rather satisfying to read the HMRC statement on this subject on 11 October. It refers to the recent stories in the media about multinationals and confirms that HMRC is alive to the risks and that they deploy specialist professionals to ensure that multi-nationals comply with the rules.

Apart from the references to people "paying the right amount of tax"(which presumably is the amount that HMRC would like you to pay), the HMRC statement is fair and balanced and should be read by all those who wish to pontificate on the matter. These two sentences really say it all:

> *"Company accounts include references to tax liabilities but it is not generally possible to identify from the accounts how much UK corporation tax has been paid. So whilst an apparently low tax rate in the company's accounts might indicate tax avoidance, it could also be the case that the business has acted entirely properly, by making use of specific tax reliefs and incentives designed, for example, to encourage capital investment or research and development".*

I think that HMRC have got it exactly right but I fear this may not be a convenient message for either the media or the politicians.

With all this going on, there is a certain irony at the decision of the ECJ this month which decided that HMRC have been over charging multinationals for years. HMRC have been wrongly charging tax on dividends from subsidiaries in the EU, whereas dividends from UK subsidiaries were not taxable as Franked Investment Income. Not much press coverage about that.

Joint Accounts

The recent case of *Matthews v HMRC TC 2329* reviewed the inheritance tax implications of a joint bank account.

The deceased transferred £94,000 to a joint account with her son and on her death HMRC claimed that the full amount of the account formed part of her estate. She was free to draw the whole amount if she wished (and so was her son) - that is the nature of a joint account. This represented a general power within Section 5(2) IHTA 1984 enabling her to appoint or dispose of the property as she thought fit.

Interestingly, reference was made to a passage in *Melville* where the Court of Appeal said:

> "*A clear example of a provision of the inheritance tax regime that produces double taxation is … the very common case of a joint bank account which permits any holder to draw on that account. The same property, the monies in the account, is under Section 5(2) taxable on the death of each holder.*"

Despite this clear statement, it is explained in the Revenue Manuals that HMRC would not seek to charge inheritance tax on the account twice but would attribute the account to the person who provided the funds. (That is all very well, but it does not deal with the growth in value of the fund - to whom is that attributed?)

Various issues arise here (not least the question of the doctrine of advancement) but it seems to me that the reservation of benefit point is overwhelming. Mrs Matthews could hardly claim that she was entirely (or virtually) excluded from any benefit from the account. She put the money into the account and she was free to draw all of it. Whether this was a gift of the whole, or half, of the account to her son, she retained dominion over the account and was not excluded from benefit from any part of it. This was clearly a gift with a reservation and the funds in the account remained in the estate.

Joint accounts are very useful things, but their utility is rather limited when it comes to inheritance tax.

Declaration of Trust

It may be of passing interest to note the recent Court of Appeal decision in *Pahkhania v Chandegra [2012] ECWA CIV 1438*.

A and B purchased a property jointly and there was an express declaration that they held it as tenants in common in equal shares. B made no financial or other contribution and ordinarily the whole property would have been treated as held on a resulting trust for A. However the Court of Appeal said that an express declaration of trust is conclusive and trumps any implied, resulting or constructive trust.

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EBTs - Loans

The recent case of *Murray Group Holdings Limited v HMRC TC 2372* concerned the tax implications of a loan to an employee from an employee benefit trust. We all know what the implications of loans are now - complete catastrophe - but that was not the case before the introduction of Part 7A ITEPA 2003 in April 2011.

Rangers Football Club had an EBT and the trustees made loans to employees and their families. HMRC argued that the full amount of the loans was taxable as earnings in the hands of the employees.

Unfortunately this potential liability pushed Rangers into liquidation and that had some effect on the team's position in the Scottish football league; the management tried to reach some accommodation with HMRC to prevent these seriously adverse consequences. They could not reach agreement; HMRC pressed the case to the Tribunal and Rangers went into liquidation. The Tribunal found in favour of the taxpayer but the damage to Rangers financial position was beyond redemption.

Anyway, back to the loans. As this case deals with events prior to April 2011 and you cannot have loans anymore, this may seem to be of rather limited interest. However, it does expose aspects which might have a much wider application.

HMRC said that these loans were shams. (That is to say, they were not really loans; they were made to look like loans but in truth they were something else.) The true nature of the payments is that they were contractual earnings of the employees.

Interestingly, when it came to the Tribunal, Counsel for HMRC did not claim the loans were shams. He claimed that the loans formed part of an intricate and secretive arrangement to place cash unreservedly at the employee's disposal. This seems to me to be just another way of saying that it was a sham. But what do these words mean? When somebody has a loan, the cash is always unreservedly at their disposal - that is what a loan is. (If I hire a car for the weekend, it is unreservedly at my disposal. I have to give it back. Well actually, I don't - I could hang on to it, as long as I keep paying for it. It does not make it my car). If what he was meaning is that the cash was never going to be repaid, then it was not a loan and the true nature of the transaction was different from that which it was represented to be i.e. it was a sham. It seems to me that for some reason, HMRC were just a bit coy about pressing the argument. The judgment of the Tribunal was mainly about whether the loans were real or not. The majority said that the loans were real and did not therefore represent earnings.

The Tribunal also considered that the Ramsay doctrine could not be applied as they saw the trusts and the loans as "genuine legal events with real legal effects". This is resonant of the concept of "genuine legal events with real legal effects" in the Court of Appeal in *Mayes* and I guess that most people would feel it is right that a genuine legal event with a real legal effect should not be completely ignored.

There was a long dissenting judgment in the Tribunal (85 pages) and this too concentrated on whether these were loans or not. Dr Poon was clearly desperate to avoid using the S word. She accepted that the loans had juristic reality but said that they were not real for any commercial purpose.

I cannot help thinking that this is just a more delicate way of saying it was not really a loan - and if it was not a loan, it is easy to conclude that it should be earnings. It is really difficult to say to somebody, I am lending you this money; juristically it is a real loan but it is not real for commercial purposes.

Where does it leave a bank employee who has the benefit of a bank loan to buy a house or car? Why is that not earnings? Is it because this loan would be accepted as genuine but the loans to the Rangers footballers were not genuine? If that is the case they should say so and not confuse us with references to juristic reality and unreal commercial purposes.

(I digress. I expect a number of people will have had the experience when explaining a difficult tax problem to a client for them to say: "Let's be commercial". I have always regarded this as code for meaning that we should pretend these rules do not exist because I do not want my objective to be frustrated by legal obstacles. My response is always to suggest that if they do not want to adhere to the legal rules, why are they going to all this trouble - why don't they just pop into the nearest bank with an Uzi.)

It seems to me that the matter ought to be concluded on the basis of whether or not the loans were real or not. Shades of genuineness are as elusive as shades of virginity. However, I guess we have not heard the last of this.

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30 November 2012

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