SQUIRE SANDERS

LACK OF INNER PEACE

HMRC do not seem to be very much interested in whether a five-figure inheritance tax liability arises and **PETER VAINES** wonders why not.

Mr Anderson is a lawyer. He was born in the UK of UK domiciled parents. After leaving university and qualifying as a solicitor, he left the UK to make his life in Hong Kong. He joined a major law firm there and has been a partner for 24 years. As befits a senior partner in one of the most prestigious firms in Asia, Mr Anderson (not his real name by the way) has been able to accumulate substantial savings. He enjoys an enviable lifestyle in Hong Kong with his Asian wife and children and it is the family's permanent home.

Mr Anderson decided to set aside some funds for his family and created a settlement to which he transferred foreign funds to the value of £400,000 for their benefit. The question arose as to whether this was a chargeable lifetime transfer for UK inheritance tax purposes or whether it was a transfer of excluded property on the grounds that Mr Anderson was not domiciled in the UK.

Where is he Domiciled?

Because he is a person with a UK domicile of origin, Mr Anderson could not simply assume that he had lost his UK domicile and acquired a Hong Kong domicile of choice. The transfer to the settlement would be chargeable unless Mr Anderson could show, on the balance of probabilities, that he had become domiciled in Hong Kong. The onus of proof was on him to do so. A chargeable lifetime transfer of this amount would give rise to an inheritance tax liability of approximately £15,000 and, however confident he (or his advisers) may be about his domicile position, it was appropriate for him to disclose the position to HMRC and to seek their agreement that no tax was payable.

Mr Anderson therefore approached HMRC, explaining that he had made this settlement for his family. Because he left the UK in 1985 and has been permanently resident in Hong Kong ever since – and positively intends to remain resident in Hong Kong for the rest of his life – he sought their confirmation that he had acquired a Hong Kong domicile of choice and that no tax arose on his transfer. He explained his circumstances fully to HMRC and provided extensive documentary evidence on all relevant aspects. He was confident that they would agree and that, if they had any doubts about his position or his future intentions, he would be able to satisfy them completely.

Regrettably, he has not been able to persuade HMRC even to consider the matter. It is not that HMRC disagree with him or are demanding the tax – they are simply not prepared to consider the issue at all.

Why are HMRC Uninterested?

Mr Anderson regards this as bizarre. His experience of tax authorities is that they are rather keen to collect taxes and the idea that HMRC cannot be bothered even to enquire into the circumstances of a wealthy lawyer who may owe £15,000 seems inexplicable.

The explanation given by HMRC is that they do not have the resources to do so. They make reference to HMRC's Revenue & Customs Brief 34/10: Domicile and Inheritance Tax (see www.lexisurl.com/W2RyM), in which they state that they will only enquire into a case where domicile could be an issue if there is a significant risk of loss of UK tax. HMRC Brief 34/10 explains their approach as follows.

"The significance of the risk will be assessed by HMRC using a wide range of factors. The factors will depend very much on the individual case but will include for example:

- A review of information available to HMRC about the individual on HMRC database.
- Whether there is a significant amount of tax (all taxes and duties, not just inheritance tax) at risk.

"HMRC does not consider it appropriate to state an amount of tax that would be considered significant as the amount of tax at stake is only one factor. It should be borne in mind that HMRC will take into account the potential costs involved in pursuing an enquiry and also those of potential litigation, should the enquiry not result in agreement between HMRC and the individual."

This is of course entirely understandable because it would be absurd to incur costs of (say) £20,000 to pursue a possible tax liability of (say) £5,000. However, one might say this is rather disingenuous because HMRC regularly pursue cases at substantial cost, far greater than the tax at stake, because the principles involved are important and have a wider significance.

Who Will Decide?

There would seem to be two possible reasons for HMRC to conclude that they should ignore Mr Anderson. The first would be that £15,000 is not enough for them to bother to collect. This seems rather unlikely – because this is rather more than the majority of UK taxpayers pay in a whole year and it would be conspicuously unfair on the majority of taxpayers for Mr Anderson to be let off, when they are pursued with vigour by HMRC for much smaller amounts.

The second reason would be because the chances of Mr Anderson being UK domiciled are not significant and therefore there is no significant risk of loss of UK tax.

HMRC claim that they do not have the resources to enquire into every case where they are likely to end up without any tax because it is probable that the taxpayer is not UK domiciled. Accordingly, their approach is to do nothing. However, if that is really their view, the only proper conclusion is that Mr Anderson is not domiciled in the UK and they should say so. We are looking here at the balance of probabilities and if, in HMRC's view, there is no significant risk of a loss of UK tax because the individual is probably not UK domiciled, the conclusion (involving minimal cost) is inescapable.

HMRC say this is a resource issue because any domicile case has the potential to involve a considerable amount of enquiry at a significant cost. This is an entirely false point: every HMRC enquiry has such potential, but that is not a good ground for suspending the collection of taxes. In any event, HMRC have the most comprehensive details about Mr Anderson's circumstances with documentary evidence about every aspect of his affairs. If they were to have any doubts about anything, they are perfectly at liberty to ask questions (HMRC are rather good at that) at virtually no cost. It never costs very much to ask a question – it is always the answers which are more difficult.

What Might Be Wrong?

HMRC have even suggested that although everything points to Mr Anderson having acquired a Hong Kong domicile there might possibly be something, somewhere, which if they enquired for long enough, might point the other way. That is obviously wrong. The test is the balance of probabilities – not whether there might possibly exist some unknown factor which might be able to create a reasonable doubt. Accordingly, in circumstances such as these, HMRC need devote no resources which are incompatible with the potential tax at stake to make this judgment.

HMRC regularly pursue cases at substantial cost because the principles involved are important and have a wider significance.

Mr Anderson is a solicitor of the Supreme Court of England and Wales (as well as being a member of the Law Society of Hong Kong) and he has expressly approved the completeness and accuracy of all representations of facts to HMRC. Such facts will include statements of his intentions (per Bowen L J in Edgington v Fitzmaurice (1885) 29 ChD 459: "the state of a man's mind is as much a fact as the state of his digestion"). It is not open to HMRC to suggest that Mr Anderson has been untruthful in his representations to them – at least not without good reason. Indeed, this is confirmed by the HMRC Charter, in which HMRC set out the taxpayer's rights and specifically say that HMRC will:

(1) Respect you.

(2) Help and support you to get things right.

(3) Treat you as honest.

(4) Treat you even-handedly.

It may be felt that HMRC's treatment of Mr Anderson is not entirely consistent with the charter.

When Will This be Important?

An observer may say this is a lot of fuss about nothing. If the taxpayer has done something which, if he is UK domiciled, would give rise to tax of £15,000 and HMRC, in full knowledge of all the circumstances, cannot bother even to argue that any tax is payable, this must surely be a clear acknowledgement that they agree he is not UK domiciled – even if they do not expressly say so.

That is a fair point – although it overlooks one very important aspect. Mr Anderson has a foreign domiciled wife. If anything were to happen to Mr Anderson, he is aware that HMRC might well seek inheritance tax of 40% of his worldwide assets on the basis that he may still be domiciled in the UK. There would only be a limited spouse exemption (even when the current £55,000 exemption for transfers to a foreign domiciled spouse is increased to the normal exemption limit from 6 April 2013), his widow may face the prospect of a demand for millions of pounds of inheritance tax and, of course, he would not be there to help her – or indeed to provide evidence on the matter. This is something that he may fear HMRC would seek to use to their advantage. Any responsible husband would recoil at his widow being placed in such a position and would like the comfort of knowing that this would not be the case. All the time HMRC refuse to consider the position, Mr Anderson can reasonably be concerned that they are merely trying to keep this possibility alive.

HMRC suggest this problem has been solved by the proposed election for the non-domiciled spouse to be treated as UK domiciled for this purpose. However, the suggestion that the widow is relieved of the burden of inheritance tax on her husband's estate by electing to pay tax on it on her death is false. It is not a relief, it is a deferral, and she only obtains this deferral by agreeing to pay inheritance tax on the whole of her worldwide assets as well.

The position would be improved if the revisions to this election included in the draft finance bill actually come into force, but although that might ameliorate a real problem facing such spouses, it would be a smoke screen, masking the issues raised in this article.

Which Way Next?

Mr Anderson is naturally aggrieved at this situation because he feels it extraordinary that a taxing authority is not prepared even to consider whether such tax should be payable. This is obviously a matter which will run and run – there are thought to be other taxpayers in a similar situation and it is likely that the matter will end up in the courts one way or another at considerable (and entirely unnecessary) cost to Mr Anderson and/or the Crown. It may give rise to an application by the trustees of the settlement, who are entitled to know whether a liability to tax exists which could fall upon them – or an application for judicial review on the grounds that Mr Anderson, like any taxpayer, has a legitimate expectation of having his claim dealt with on its merits.

Domicile as a tax concept differs from the other main determinants of an individual's tax liability in that it reflects, to a significant extent, the individual's statement of mind at a particular time. The UK is unusual among leading taxing jurisdictions in having placed such an emphasis on domicile (in the sense used here) as a basis for taxation. Accordingly, it would seem incumbent on HMRC to have a mechanism for individuals such as Mr Anderson to be able to ascertain from the tax authorities whether he is liable to any tax. To deny him that right seems unjust, despite the current fashion for self assessment, because there is no enquiry window or any other means of obtaining finality for Mr Anderson.

Mr Anderson will not be the only person who feels that there is something wrong here. His determination to shine some light into the practices of HMRC might have benefits for all of us, not least to provide the sort of "inner peace" that the department are presently so keen to promote.

Contact

Peter Vaines
Barrister
T +44 20 7655 1780
E peter.vaines@squiresanders.com