UK Tax Bulletin

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Latest Rates of Inflation and Interest

The following are the current rates at May 2013

Current Rates	April 2013
Retail Price Index: April 2013	249.5
Inflation Rate: April 2013	2.9%
Indexation factor from March 1982: to April 1998 to March 2013 to April 2013	 1.047 Not yet published 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

Since 6 April 2010: 4%

Residence

The statutory test is now in force and many of the difficult points are being ironed out. The particular horror story I referred to in February relating to the position of a person with a home here and a home abroad and the 91 consecutive day rolling period seems now to have been resolved.

The legislation makes it clear that if you have a home in the UK and a home abroad but you are not present in that overseas home for more than 30 days during any 91 consecutive day period you will be conclusively resident under the automatic UK residence test.

However, HMRC have said that if you spend more than 30 days in the overseas home in total during the entire tax year (forget about the 91 day period) then the automatic test will not apply. This has been confirmed by the latest version of the Guidance Notes issued this month (para 1.27) but strangely, none of the numerous examples deals with the point.

This seems to conflict with the legislation but that doesn't matter providing we can rely on it. (Anybody getting a feeling of déjà vu here? Legislation saying one thing, HMRC practice saying another, people relying on HMRC practice …).

Split year treatment continues to be a source of concern because it is seriously complicated - and the tom toms tell me it is going to get worse. There were two paragraphs about split year concessionary treatment in IR20 and they are being replaced by 25 pages of legislation - and counting.

It will be interesting to see the amendments which are made during the passage of the Finance Bill and then (I hope) we will receive a final version of HMRC guidance so we know what it is all supposed to mean.

Business : CGT

The Upper Tribunal have recently heard the appeal by *Elizabeth Moyne Ramsay v HMRC [2013] UKTT 0226* in which the point at issue was whether a property, divided into 5 flats, was a business for the purposes of capital gains tax - and in particular whether it fell within Section 162 TCGA 1992 which deals with the transfer of a business to a company in exchange for shares.

Mrs Ramsay conducted various activities at the property but the First Tier Tribunal said that these activities were normal and incidental to the owning of an investment property. They arose by necessity when one owns a property which is let out as flats. Accordingly, the property was an investment, Mrs Ramsay was not carrying on a business and Section 162 did not apply.

The Upper Tribunal went through all the authorities regarding the meaning of a business. They noted that there was no statutory definition of a business and that it should be construed broadly according to its unvarnished ordinary meaning.

One would have thought that a serious obstacle in this case was the facts found by the First Tier Tribunal. However, the Upper Tribunal considered that the First Tier Tribunal had made an error of law. The relevant question was whether the activities of Mrs Ramsay constituted a business but the Tribunal had considered whether she was carrying on a trade, which is a very different matter.

Furthermore, the First Tier Tribunal did not properly assess the degree of activity undertaken by Mrs Ramsay. They had said that the activities were undertaken to maintain and enhance an existing investment property and thereby enhance the available returns by increased rents.

The Upper Tribunal did not agree. They set out some general guidelines regarding what represents a business:

> "*It falls to be considered whether Mrs Ramsay's activities were a serious undertaking earnestly pursued or a serious occupation; or the activity was an occupation or function actively pursued with reasonable or recognisable continuity, whether the activity had a certain amount of substance in terms of turnover, whether the activity was conducted in a regular manner and on sound and recognised business principles, and whether the activities were of a kind which, subject to differences of detail, are commonly made by those who seek to profit by them*".

The Upper Tribunal decided that these tests were satisfied and that Mrs Ramsay was carrying on a business and was entitled to her relief.

This was of course a case relating to capital gains tax and not inheritance tax. However, there have been a number of cases where such activity has been considered for the purposes of business property relief where the term "business" is also used and is also not defined. Please read on.

Business Property Relief : IHT

The First Tier Tribunal has also recently heard the case of the *David Zetland Settlement v HMRC TC 5387*. In this case the trustees of a settlement owned commercial properties which were let on a commercial basis. The issue was whether the trustees were carrying on a business for the purposes of IHT business property relief because if they were not, the settled property was subject to the 10 year charge to inheritance tax. The relevant test in these circumstances was found by Section 105(3) IHTA 1984 which allowed business property relief unless the business "consists wholly or mainly of one or more of the following, that is to say dealing in securities, stocks or shares, land or buildings or making or holding investments".

The trustees dealt with the general management of the properties owned by the settlement and were assisted by various staff members. There was an impressive list of services provided to the tenants - rather more perhaps than had been undertaken by Mrs Ramsay.

There were a number of full time and part time staff including a general handyman, a property manager, an in house solicitor and 2 secretaries. There were internet services, cleaning services and 24 hour security as well as a café, a gym and hair salon - although the latter were not operated by the trustees.

However, the Tribunal considered that these factors were insufficient "to rebut the mainly investments argument". (sic)

The argument of HMRC and accepted by the Tribunal was that the trustees activities were wholly or mainly the making or holding of investments.

It is difficult to reconcile this First Tier Tribunal decision with that of the Upper Tribunal in *Elizabeth Moyne Ramsay* and it cannot be explained simply by the fact that one related to capital gains tax and the other to inheritance tax. Although the legislation was different, the question was the same - was this an investment or was it a business. Both needed to consider the nature of a "business" for which there was no definition in either code.

Hastings Bass : Trustees Errors

The recent Supreme Court decisions in *Futter v Futter* and *Pitt v Holt* are landmark decisions, evidenced by the fact that they engaged a panel of 7 Supreme Court Justices who gave a unanimous judgment. I cannot begin to summarise such an important judgment. All I propose to say is that the Hastings Bass principle whereby the Courts have given relief to trustees by setting aside actions which resulted in unexpected tax consequences on the grounds that they had innocently failed to take into account a relevant factor (i.e. the tax charge) has now been overturned. Trustees will no longer be able to obtain a morning after pill by the Courts.

Where the trustees have acted within their powers, seeking advice from apparently competent advisers, they will not generally be in breach of their fiduciary duty even if the advice turns out to be wrong. Their only remedy will be against the advisers - although there will be many cases where innocent mistakes will be made and there will be no remedy to the unexpected tax charge.

It is likely that a transaction by the trustees will only be set aside in future if it was made by the trustees in breach of their duty. It will be a brave trustee who seeks relief on these grounds.

The second strand of the Supreme Court judgment was whether actions of the trustees could be set aside on grounds of mistake. This will clearly be the area where everybody will concentrate in the future. The test here is much simpler than the traditional test with no distinction being made between mistakes of fact and mistakes of law. The test will be whether there is a "a causative mistake of sufficient gravity" to engage the Courts sympathy and the exercise of their discretion. It will be interesting to see how this develops - although the Court did emphasise that this is an equitable remedy and is unlikely to be viewed sympathetically where a tax scheme has gone wrong.

(The Supreme Court also put an end to the largely inexplicable distinction between "effect" and "consequences" created by *Gibbon v Mitchell*, which is extremely welcome.)

It remains to be seen how this decision will be viewed in other jurisdictions. One might expect those countries whose trust law closely follows English law to embrace the decision fully, but others (such as Jersey) might take a more independent stance. There are some interesting constitutional issues here because the Privy Council is the highest appeal Court for many Commonwealth countries (and the Channel Islands) and will normally follow decisions of the Supreme Court.

I imagine that trustees will be very keen to investigate this and to ensure that the governing law of their trust will be one which provides them with maximum protection.

Farmhouses

HMRC have published an amendment to their Inheritance Tax Manuals concerning farmhouses for the purposes of Agricultural Property Relief. This sounds like a yawn, but actually it is eye popping.

HMRC have been looking at the case of *Golding v HMRC TC 1211*. It was common ground that the property in issue was a farmhouse and the question was whether it was of a character appropriate to the agricultural land owned by the deceased. The Tribunal said that it was.

HMRC clearly do not like this decision and they are instructing Inspectors that the decision is not a binding precedent. They drew attention to other cases (equally not binding - but where HMRC had a more favourable result) which they say are still relevant and should be followed instead.

HMRC said that they "were prevented by an order by the Tribunal from arguing that the house was not a farmhouse". Is that really what happened? It certainly is not. The Tribunal said that the "farmhouse" argument did not arise because "it has been agreed by both parties as a result of the correspondence that the house is a farmhouse and we shall deal with the appeal on that basis".

HMRC said that the Tribunal "observed in passing that it considered the deceased's residence would have qualified as a farmhouse". This is highly questionable. The Tribunal's judgment was much more than a mere passing observation. They specifically noted that they were not required to decide whether the house was a farmhouse because that had already been agreed by the parties, but had they been asked to do so they would have decided it was a farmhouse. They went on to explain how they came to this considered view and added that "*we are satisfied that the educated rural layman would also agree that the house was a farmhouse*".

HMRC say that if a taxpayer seeks to use this decision to argue that a residence should qualify as a farmhouse they should be referred to the Revenue Manuals which explain the position differently. The clear implication here is that despite the decision of the Courts, the view that HMRC take on the matter should be preferred.

The Tribunal found that the lack of profit was not detrimental to a decision that the farmhouse was of a character appropriate to the land. This sounds reasonably clear. However HMRC do not like that either and say that they are not going to take any notice of the decision and their view remains the same.

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HMRC suggest that other cases such as *Antrobus* should still be considered. *Antrobus* was extensively reviewed in *Golding* particular in connection with the importance of profitability and HMRC's arguments were rejected. HMRC express the view that the comments in *Antrobus* relating to the existence of a farmhouse (with which they agree) should be accepted but those parts of the decision relating to profitability (with which HMRC do not agree) should be disregarded.

It is one thing for the losing party to be dissatisfied with the judgment of the Court but it cannot be open to HMRC to say publicly as a matter of policy contained in their Manuals that they will ignore the Tribunal's decision - even if it does not have precedential value. If they do not like the decision they always have the opportunity to appeal and present their opposition to the higher Court (an opportunity not always available to the privately funded taxpayer).

I wonder what HMRC would say if the taxpayer behaved like this.

Usufructs

HMRC have issued a statement regarding the inheritance tax treatments of Usufructs. HMRC confirm their view that the definition of a settlement in Section 43(2) IHTA 1984 means that a Usufruct will probably be treated as a settlement for inheritance tax purposes - although the precise circumstances need to be considered as arrangements differ between jurisdictions. In their view a Usufruct gives rise to an interest in possession in the property concerned.

It is helpful to have this clear view by HMRC on the matter. However, those who are learned in this subject say that the analysis is not quite so simple.

There seems to be considerable doubt whether a Usufruct is a settlement at all for inheritance tax purposes not least because the property is not held for persons in succession or any of the other necessary requirements of Section 43. There is also some real difficulty of fitting a proper legal analysis of the nature of a Usufruct in France into the definition of a settlement in the UK. (It may also be relevant to consider the terms of Section 43(2) and whether the administration of the property in the other country is governed by provisions equivalent in effect to those which would apply if the property were subject to English law.)

The matter is further complicated by the fact that HMRC regard a Usufruct governed by French law as not being a trust for income tax and capital gains tax purposes. (See HMRC Manual CG 31305). This not only creates confusion, but also a number of anomalies, not least that in the event of a sale the occupiers rights may not be particularly valuable and the "owner" (the person entitled to the property subject to the Usufruct) would not be able to benefit from the main residence exemption as he would for trust property under Section 225 TCGA 1992.

I think there is some way to go with all this but in the meantime there is clearly scope for lots of arguments.

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VAT Input Tax

I read with interest the recent case of *JNK 2000 Limited v HMRC TC 2635* in which that taxpayer's claim for input tax recovery on costs associated with a helicopter were denied by HMRC. There was no great principle at stake here, it being mainly a question of fact whether the expenditure was incurred for the purposes of a business (a rather different test than which applies for direct tax purposes). It was however interesting to observe that HMRC concluded that there was no business use - whereas the Tribunal decided that the whole of the input tax was incurred for business purposes.

Even so, it seems that the decisive factor was the impressive evidence produced by the taxpayer of his business purpose and the care he took accurately to record (and pay for) any private use for the aircraft.

The decision follows (or at least is consistent with) the VAT Tribunal in *C J Kent v HM Customs & Excise (1995)* where the business purpose for the cost of maintaining the taxpayer's helicopter license was also found to be for the purposes of the business.

P S Vaines
Squire Sanders (UK) LLP
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Contact

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

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