SQUIRE SANDERS

UK Tax Bulletin

July 2013

SQUIRE SANDERS

Introduction

SQUIRE SANDERS

Latest Rates of Inflation and Interest

The following are the current rates at July 2013

Current Rates	July 2013
Retail Price Index: June 2013	249.7
Inflation Rate: June 2013	3.3%
Indexation factor from March 1982:	
to April 1998	1.047
to May 2013	Not yet published
to June 2013	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%

Tax Incentives

You have to laugh. George Osborne says it is important to make the UK competitive to encourage foreign businesses to set up here. So we have a low rate of corporation tax, special tax reliefs for research and development expenditure, an even lower rate of tax on intellectual property and so on. This is called a Good Thing. However, if Ireland, or Luxembourg, or Jersey (or actually anybody else) have a low rate of corporation tax or introduce tax reliefs to encourage foreign businesses to set up there, they are conspirators in international tax avoidance which is a very Bad Thing.

I read last week that the German Finance Minister is complaining about our patent box legislation (which provides a very low rate of tax on income from intellectual property) saying it should be outlawed because … you know how it goes.

A lot of good can come out of the present initiative for international co-operation on disclosure and tax compliance. However, if everybody regards their tax incentives as sensible fiscal management and tax incentives introduced by anybody else as absolutely unacceptable, then all ideas of possible international co-operation will go straight out of the window.

GAAR

The Finance Act 2013 came into force on 17 July and with it a number of new provisions. One of the most important is the General Anti Abuse Rule which applies to tax arrangements taking place after that date.

Where arrangements are entered into with a main purpose of obtaining a tax advantage, they will be regarded as abusive (and therefore subject to counteraction) if they "cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions".

I may not be the first person to observe that the term "abusive" is therefore being defined as unreasonable, which many may feel is not the same thing at all.

In deciding whether arrangements can reasonably be regarded as a reasonable course of action you need to consider whether what you are doing is intended to exploit any shortcomings in the legislation and whether it involves any contrived or abnormal steps. Furthermore, you have to consider what policy objectives should be implied by the legi\slation. I don't know how the ordinary taxpayer is supposed to do that - but never mind. Unfortunately, it is not enough to come to a sound and honest view of these matters. You have to second guess what HMRC will regard as reasonable (or doubly reasonable) and what they say the policy objectives were. Good luck with that.

If HMRC think that there have been abusive tax arrangements which ought to be counteracted, they will ask the taxpayer to explain why they should not be. If HMRC are not persuaded, they cannot just take counteractive steps immediately. They must first refer the matter to the GAAR Advisory Panel who will express their view. Sounds good - but it will not help. If the GAAR Advisory Panel says the transactions are OK, HMRC are free to proceed anyway if they do not agree with the Panel. (And as

HMRC will have already decided that the arrangements are abusive, they are hardly likely to change their mind).

You will not want to know this next bit. If the matter goes to Court, the Court must take into account the HMRC guidance in deciding what it all means.

Forgive me, but the following extract from Alice in Wonderland is irresistible:

> " *"When I use a word", Humpty Dumpty said, in a rather scornful tone, "it means just what I choose it to mean - neither more nor less".*
>
> *"The question is", said Alice, "whether you* ***can*** *make words mean so many different things".*
>
> *"The question is", said Humpty Dumpty, "which is to be master - that's all." "*

I wonder where this leaves me on my proposed trip to Paris (which I have mentioned before). I do not want to pay the Airline Passenger Tax and solely for this reason, I go to Paris by Eurostar. Avoiding payment of the tax is my main reason for making the arrangements to go by train. Is this reasonable or abusive? There is clearly a shortcoming in the legislation (the APT does not apply to trains) so my deliberately contrived arrangement to avoid APT should fail.

It won't of course, but only because it is just simple to understand. Parliament did not intend that APT should be charged in these circumstances. Who says so? But it's obvious …. isn't it? Well actually no.

Maybe it is equally obvious that the Patent Box legislation allowing companies a lower rate of tax is exactly what Parliament intended. Not according to the Public Accounts Committee who think it is tax avoidance.

Surely sometime it will be realised that some intellectual rigour should be introduced into the debate.

Anyway, it is no good complaining. This is the law now and it will be very interesting to see how this plays out. One thing seems clear - the initial submissions to HMRC explaining why the arrangements are not abusive are likely to be of paramount importance so I think we are in for a lot of work.

Annual Tax on Enveloped Dwellings

This tax has been in force since 1 April 2013. However, the reliefs from the ATED for expensive (company owned) residential property which is commercially let or which is to be developed now also apply for SDLT purposes - but only from the date of Royal Assent (17 July 2013).

HMRC have issued a draft of the ATED tax return which needs to be submitted by 1 October 2013, (and the tax paid by 31 October 2013). A return is still required if any of the exemptions are claimed.

Details of the property are naturally required and so is the basis of valuation. HMRC want to know whether a professional valuation has been obtained or whether there has been a pre return banding check. (Anybody wanting to know how the Tribunal will approach the valuation of the property might usefully read the recent First Tier Tribunal (Lands Chamber) case of *Blum v HMRC [2013] UKUT 0304*

(LC). This dealt with a commercial property and is not directly relevant, but it did demonstrate the importance of decent evidence. The evidence of both sides seemed a bit inadequate so the Tribunal got on with it on their own. If either side had put in some good evidence they would probably have won hands down.)

HMRC confirm that a company acting as a trustee of a trust owning a UK property is exempt from the ATED and no return is required and so is a company which holds the property as trustee of a bare trust.

HMRC have also announced that ATED is going to be covered by DOTAS. There are enabling provisions in the Finance Act 2013 and draft regulations have been published setting out the type of ATED arrangements which must be disclosed to HMRC under DOTAS. These are likely to come into force later in the year; the draft seems to indicate that 1 October 2013 will be the relevant date and will apply to arrangements which took place after 12 December 2012.

The next ATED tax return will be due on 1 April 2014 with payment being required by 30 April 2014.

IHT : Non domiciled spouse election

The Finance Act 2013 provides an opportunity for a foreign domiciled spouse to elect to be treated as UK domiciled to avoid the application of the restricted spouse exemption (now increased from £55,000 to £325,000) where they inherit assets from their UK domiciled spouse.

This is an extremely valuable relief because the restricted spouse exemption was a source of genuine anxiety for many couples who simply assumed that because they were married there would be no inheritance tax on the first death.

This election may sound like putting your head in the lion's mouth because by making the election the spouse is thereupon treated as UK domiciled and within the scope of inheritance tax on the whole of their worldwide assets. Fortunately, this risk has been largely removed because if the surviving spouse is non resident for 4 tax years following the election, their non domicile status resumes. This will be a very welcome relief to many people facing these risks.

However, it is not all plain sailing as a recent explanatory note by HMRC makes clear.

They give an example of a husband who transfers £1 million to his foreign domiciled wife. Subsequently (and independently) she transfers some of her foreign assets to an offshore trust. If her husband dies she could make the election to be treated as UK domiciled so that his gift to her benefits from the spouse exemption. However, by doing so, she is treated as domiciled in the UK for all IHT purposes and her independent transfer of her foreign assets to a foreign trust becomes a chargeable transfer. This is a real trap and could put her in serious difficulty.

What this example indicates is that if a UK domiciled spouse makes a gift to a foreign domiciled spouse, the donee has got to be really careful about what they do with their own assets because if the donor dies they could find themselves in trouble.

I see a possible problem if the husband had given the wife a gift more than 7 years ago. It would no longer be a PET but it could be a gift with a reservation unless the wife had made quite sure that the

husband was excluded from any benefit from the subject matter of the gift. She could not claim the benefit of the exclusion from the gifts with reservation provision because that exclusion would only apply to the first £325,000. The subject matter of the gift might therefore be treated as remaining in the estate of the donor. There would be no spouse exemption on death because the asset would not pass on death. Nor would one of these elections help for the same reason. You can make an election in respect of a failed PET - but this is not a failed PET so the non dom spouse ends up with a real and unexpected problem.

In principle this is a very useful election - but there are lots of stings in its tail.

Remittances

HMRC have written an explanatory letter to individuals who have claimed the remittance basis to assist them in getting their tax returns right by explaining the meaning of a remittance. Given the almost unbelievably complexity of the legislation, I think this is extremely helpful.

HMRC provide a number of examples where a remittance of foreign income arises in circumstances which perhaps might be overlooked by the taxpayer. However, some of the examples are perhaps a little arguable - and certainly should not be accepted out of hand without further consideration. For example, HMRC say that a remittance occurs when:

> "*You transfer some of your foreign income to the UK account of a registered charity.*"

This is certainly arguable, but if you have a choice, it would obviously be safer to pay the money to a foreign account of the charity, if it has one.

Similarly, they say a remittance occurs when:

> "*You buy shares in a UK registered PLC from a foreign broker with your foreign income.*"

Again this is arguable - although possibly that may be of limited relevance because it is likely to be regarded as a remittance when the investment is sold anyway.

The comments regarding the use of credit cards are interesting. HMRC say that a remittance occurs when:

> "*You use a credit card issued by a foreign bank in the UK for day to day expenditure and pay the credit card bill using your foreign income.*"

The crucial factor here is the payment of the credit card bill using the foreign income. The reasoning is that you are effectively spending your foreign income in the UK via the medium of a credit card.

HMRC go on to say that a remittance also applies when:

> "*You use a credit card issued by a UK bank while on holiday abroad and pay the credit card bill using your foreign income.*"

The reasoning here is that the use of the UK credit card creates a debt in the UK and the discharge of that debt by the foreign income represents a remittance.

Accordingly, for those wishing to avoid problems with remittances it is obviously preferable to ensure that any UK credit card is discharged by funds which are not foreign income; similarly it would be best to avoid using any foreign credit cards in the UK.

Non executive directors : IR 35

HMRC seem to be on the warpath against non executive directors. The Finance Act 2013, extends the definition of "worker" for IR35 purposes to office holders. Prior to 6 April 2013 if the workers only relationship with the client was as an office holder then the IR35 rules did not apply. They do now. They always applied for NIC purposes and with effect from 6 April 2013 they will apply for income tax as well.

The overriding principle remains that IR35 will only apply if the services are provided in circumstances where the worker would be regarded as an employee if they had been engaged directly by the client. This is always the battleground but HMRC helpfully explain that these new rules will not apply:

(a) just because a worker is a director of their own personal service company;

(b) just because their job title refers to them as an officer but they do not hold an office.

I have a feeling that this change might be rather less important that is being suggested - but we shall see.

P S Vaines
Squire Sanders (UK) LLP
31 July 2013

Contact

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