SQUIRE PATTON BOGGS

UK Tax Bulletin

July 2014

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Introduction

Latest Rates of Inflation and Interest

The following are the current rates at July 2014

Current Rates	July 2014
Retail Price Index: June 2014	256.3
Inflation Rate: June 2014	2.6%
Indexation factor from March 1982: to May 2014 to June 2014	 2.221 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

To 6 April 2014: 4%

From 6 April 2014: 3.25%

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Finance Act 2014

The Finance Act 2014 was enacted on 16 July 2014 so all those things like Accelerated Payments and Follower Notices are now all in force. More of this later.

ATED - Developments

HMRC are considering whether to allow those who are entitled to a relief from ATED to apply for exempt status so that they would not need to file a return – at least not so often. This sounds really helpful. Less agreeable is the confirmation that the new Follower and Accelerated Payment Notices will apply equally to the ATED if "tax arrangements" of an avoidance nature have been entered into.

Tax Deductible?

An interesting debate is taking place about whether the ATED charge is deductible by the company for tax purposes.

At first sight you would think not, but on further analysis there seems no good reason why the charge should not be deductible – assuming of course there is an appropriate source of income from which it can be deducted. In many cases the UK residential property held by the company will not give rise to any income, as it would simply be accommodation provided for the individual. For this reason it would not form part of any property lettings business, even if the company had other rental income. Of course, if it is let commercially to a third party, the ATED would not apply anyway. However, if it were to be let to a connected person on commercial terms, the ATED would still apply and the rental income would be taxable, so why should the charge not be deductible from the rents. The fact that it is a tax should not get in the way – employer's NIC is deductible and so are other taxes (such as insurance premium tax), so what is so special about the ATED.

The position would seem to be even stronger where the company owning the property carries on a trade and the property is used by an employee who suffers a benefit in kind charge for his occupation.

I understand that HMRC do not consider that the ATED charge is tax deductible and I imagine some official statement will be forthcoming before very long.

ATED related capital gains

The ATED related capital gains tax charge applies to the gain on the property beyond 5 April 2013. A valuation at 6 April 2013 is obviously required and there has been some uncertainty whether this should be an open market valuation or whether the specific capital gains tax valuation rules should be applied.

HMRC recently confirmed to the British Property Federation that the valuation is self assessed by the property owner and "therefore" an open market valuation can be used.

It may not matter very much, but I cannot see how this can be right. This is a capital gains tax charge and the gain is computed by reference to Schedule 4ZZA TCGA 1992. We may be looking at the base value, rather than the disposal value but that does not make any difference. The base value is specifically determined by paragraph 3(2) as being the market value at 5 April 2013. Market value is not specifically defined for this purpose so the specific CGT valuation rules in Section 272 TCGA 1992 must apply.

Nor does it seem to be relevant that the value is self assessed by the property owner. The value put forward by the property owner is of no consequence. What matters is the view of HMRC regarding the value of the property. Either HMRC agrees with the property owners suggested value or it does not – but in either event it is the value considered to be accurate by HMRC which will be the value to be used for this purpose – subject to an appeal of course.

EBT and Loans

The Upper Tribunal has now delivered its judgment in the recent case of *HMRC v Murray Group Holdings Limited [2014] UKUT 0292* which concerned the tax implications of a loan to an employee from an employee benefit trust established by Rangers Football Club. We all know what the implications of loans are now since the introduction of Part 7A – a complete catastrophe – but things were different before April 2011.

In this case HMRC took the view that the loans from the EBT to the employees and their families were really earnings of the employees.

The reasons for this treatment were not entirely clear. HMRC had argued that the loans were shams (that is to say they were not really loans; they were made to look like loans but in truth they were really something else). However, HMRC did not argue this before the Tribunal. They claimed that the loans formed part of an intricate and secretive arrangement to place cash unreservedly at the employee's disposal.

This is an odd argument because when somebody has a loan the cash is always unreservedly at their disposal – that is what a loan is. If however HMRC were arguing that the cash was never going to be repaid then it was not really a loan. That would surely mean that it would be a sham – because the true nature of the transaction would be different from that which it was represented to be. For some reason, HMRC seemed to be a bit coy about pressing this argument before the First Tier Tribunal which is more curious because that is the issue on which the Tribunal concentrated their attention viz, 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 because they considered the trusts and the loans were genuine legal events with real legal effects. (This is resonant of the Court of Appeal decision in *Mayes* and it does not seem too objectionable to say that a genuine legal event with a real legal effect should not be completely ignored.)

At the First Tier Tribunal there was a long dissenting judgment by Dr Poon which concentrated on whether the loans were real or not. Dr Poon accepted that the loans had juristic reality but said that they were not real for any commercial purpose. I am not clear about what this meant – and how it would affect for example a bank employee who has a bank loan to buy a house. Should that be treated as a loan or as earnings? Presumably such a loan would be accepted as genuine but the loans to the Rangers footballers were not, even though they had juristic reality?

The Upper Tribunal reviewed everything at great length and found in favour of the taxpayer. They upheld the conclusion of the First Tier Tribunal on the application (or rather the lack of application) of the Ramsay principle to these circumstances. Furthermore, they said that the First Tier Tribunal had approached the matter of the loans with a purposive construction of the provisions and with a realistic view of the facts. They had been entitled to conclude that the loans were genuine – and to reject the arguments of HMRC to the contrary.

HMRC had a lorry load of other arguments (as you might expect in a case as important as this) but the Upper Tribunal rejected practically all of them.

Having regard to the very wide implications of this case, an appeal to the Court of Appeal must surely be inevitable.

Accelerated Payments and Follower Notices

The new rules for accelerated payments and follower notices are now in force so that anybody who has participated in a DOTAS scheme, or has arrangements which have been given the thumbs down by the GAAR Advisory Panel are likely to have to pay the disputed tax up front.

Actually, there does not need to be any tax in dispute. Indeed, it seems clear that in many cases there will be no dispute. But you still have to pay the tax until such time as HMRC decide (if they do) that it is not disputed.

The same applies to a follower notice where HMRC is of the opinion that there is a final judicial ruling in another case which if applied to your case, would deny the tax advantage. HMRC can then ask you to pay the tax. You do not have to, but you risk a 50% penalty if your case eventually loses. However, your case must be a tax avoidance case and the judicial ruling must be in another tax avoidance case. A decision in another case which is not to do with tax avoidance will not give the necessary support for a follower notice. (However, a decision in another case which is contrary to the view of HMRC will not prevent the issue of a follower notice.)

Regrettably, there is no right of appeal against such notices.

No I am not making this up. It is now the law that you can make a claim for a tax deduction but before HMRC have even considered it, they are entitled to make you pay the tax; and there is no appeal.

There is Judicial Review of course - but that is seriously complicated and expensive and has to be based on an improper application by HMRC of the rules. Just disagreeing with their conclusions or their approach will not be enough - there has to be some genuine impropriety.

However, if the taxpayer considers that the relevant conditions for the issue of a notice has not been satisfied, or the amount which has been claimed is wrong, they are entitled to make representations - and HMRC are obliged to consider those representations and decide whether to confirm or withdraw the notice. It seems to me that the drafting of those representations is going to be incredibly important because it is on the basis of those representations (and the rejection of them by HMRC) that an application for Judicial Review is likely to be founded.

HMRC have issued some guidance on this important topic. It is very lengthy (it goes on for 65 pages) but it is helpful nevertheless and certainly worth a read.

The section relating to accelerated payments starts with the irritating proposition that:

> "*There is no inherent presumption that tax in dispute should sit with the taxpayer rather than the Exchequer.*"

Well actually - there is. In fact there is more than a presumption. Neither the Exchequer nor anybody else should be able to take away your property unless they have a legal right to it - so before they have established their legal right they should keep their hands off. However, the Finance Act 2014 now gives them the legal right to claim the money so there can be no complaint. This may be a draconian power, but it is the law, although I think it would be better if they did not pretend that they are sort of entitled to the money anyway.

Commercial Business

The Tribunal recently considered whether a business was being carried on commercially: *Beacon Estates (Chepstow) Limited v HMRC TC 3808*. The company carried on a yacht chartering business and had one or two difficulties which gave rise to losses. In considering whether those losses were eligible for relief, it was necessary to determine whether Section 393A TA 1988 (and now Section 44 CTA 2010) applied - both expressing the same test that the trade must be carried on "on a commercial basis and with a view to the making of a profit in the trade or so as to afford a reasonable expectation of making such a profit".

The Tribunal said that "with a view to the making of a profit" should be interpreted to mean "allow a realistic possibility of making a profit" thereby importing an objective element into the test.

Applying this test to the facts of the case, they decided that there was a realistic possibility or reasonable expectation of the company making a profit from its chartering activities and the losses were allowed.

A case like this is heavily fact dependent and rarely provides any general principles - but it is interesting to note the arguments of HMRC. They said that the company did not have a reasonable expectation of profit because, inter alia, they had unreasonably assumed that there would be no unexpected economic shocks such as the 2008 banking crisis and subsequent global recession.

Goodness me. If the test of commercial trading is that you must assume events such as the banking crisis and a global recession, there will be precious few people who qualify.

The Tribunal did not take any notice of this argument but as it was seriously addressed by HMRC in a court of law, one might reasonably assume they think there is something in it and we may see it again in due course.

Remittance Basis : Dual Contracts

In the Autumn Statement it was announced that dual contracts were for the chop. Where a UK resident works in the UK and partly abroad the whole of his earnings are taxable. However if he is not UK domiciled, any earnings from a separate contract with a foreign employer where the duties are performed wholly abroad are taxable on the remittance basis. If this is not genuine, or if the amounts attributable to the foreign contract are excessive, HMRC have plenty of powers to unravel the arrangements.

However, those powers were somehow thought to be inadequate and the Finance Act 2014 introduced new rules so that where the foreign contract is with an associated employer in a low tax jurisdiction, the remittance basis will not apply and the whole lot will be taxable in the UK.

HMRC have now published a guidance note on the various conditions which apply to the restriction of the remittance basis on dual contracts.

These restrictions will not apply where the arrangements are not made for tax avoidance reasons or where the foreign tax on the overseas earnings is more than 29.25% - and there is a special exclusion for a director who has less than 5% of the employers share capital. However this is overridden if the individual is "a senior employee" or he "receives a higher or highest level of remuneration". These terms are not defined and the guidance merely says that it will depend upon the facts and you will need to consider your individual circumstances. Well yes. HMRC add that they would consider a senior employee to be one "involved in higher level management and decision making". Er, I am not sure we are making progress here.

They go on to say that you "might be" a senior employee if you are responsible for implementing higher level or global business strategies … I'm sorry, I think I've had enough of this.

Let's see how we get on with "higher paid". This is not defined either and they say that there is no absolute level of pay that is relevant. The guidance says that "whether your pay level is high relative to other employees in the same group of companies" is "a matter of comparing your overall remuneration … to that of your fellow employees". I think I am losing the will to live here.

However, they do get more specific. HMRC say that if you are liable to tax at 45% on your earnings that will be a good indication of someone who is higher paid. Of course it doesn't. It depends what everybody else is being paid.

It is really not helpful for them to say that "there is no absolute level of pay that is relevant" – and then say that £150,000 "will be a good indication of an employee who is higher paid". Does that not mean that £150,000 is a relevant level of pay. Of course it does.

I am usually quite a fan of the guidance notes issued by HMRC – but I do not feel the love from this one.

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