SQUIRE PATTON BOGGS

UK Tax Bulletin

October 2014

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Introduction

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Latest Rates of Inflation and Interest

The following are the current rates at October 2014

Current Rates	October 2014
Retail Price Index: September 2014	257.6
Inflation Rate: September 2014	2.3%
Indexation factor from March 1982:	
to August 2014	2.235
to September 2014	2.243

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%

Residence

A recent issue has arisen which highlights how getting married might unexpectedly affect your residence status.

Let us assume that you made a capital gain in 2013/14. You are not resident because you have insufficient UK ties under the statutory residence test so, (subject to the temporary non residence rules), the capital gain will be free of tax. However, it is possible that if your wife were to be resident during the year, that would give you an additional UK tie which would cause you to be UK resident.

Whether your wife is resident will depend upon her day count and on which day count table applies to her for the year - and that will depend on whether she is an "arriver" or a "leaver", that is to say whether she was resident in any of the previous three years. Establishing her residence for those earlier years would be very difficult to determine under the old rules but we can of course make the election under Schedule 45(154) Finance Act 2013 to apply the new rules for this purpose. Accordingly, her residence might depend upon her day count for (say) 2010/11.

However, you might not even have met her by then - so we have a situation where you may have a huge liability to capital gains tax because of the number of days that somebody who you did not know had spent in the UK in 2010.

Of course, it would have been the fault of her professional advisers. They should have told her in 2010 that she should watch how many days she spends in the UK because in a few years' time HMRC might change the rules and she might marry somebody and they might make a capital gain and the number of days she spends in the UK that year could cost him millions of pounds in capital gains tax.

And your advisors would be equally guilty. They should have told you that if you meet somebody, you had better find out (before you get married), how many days she spent in the UK in the previous three years just in case HMRC change the rules and just in case you make a capital gain sometime in the future.

Is this bonkers or what? This is obviously so unreasonable and capricious that I hope some amending legislation might be forthcoming before too long.

(One might think that if they were not married in the earlier year then It should not matter because she would not have been a spouse and could not therefore represent a family tie. Unfortunately not. The issue here is whether she was resident in the earlier years by reference to her own circumstances - irrespective of her marital status at the time.)

Mistake: Rescission

The decision of the Supreme Court in *Pitt v Holt* [2013] UKSC 26 was pretty much last word on Mistake and the effect that it has on a contract or disposition. It is therefore interesting to read the most recent case on the matter *Wright v NatWest Bank Plc* [2014] EWHC 3158 in which the High Court considered how far they were able to exercise their discretion to rescind a disposition on the basis of a unilateral mistake.

The High Court said that a unilateral mistake requires a more stringent test when considering a claim for rescission, The mistake cannot be a pure question of fact nor can it have arisen out of inadvertence of ignorance. The causative mistake must be so grave that it would be unconscionable for the Court to refuse relief. This demanding test is fully articulated in the judgment (and was satisfied in the circumstances of Mr Wright).

While on the subject of rescission, I heard on the BBC News last week that as a teenager, Dame Judy Dench was woken by her father each morning, not with traditional abuse (as befits a slumbering teenager), but by reciting poetry. How lovely. The particular poem she recalled was an extract from the Rubaiyat of Omar Khayyam.

Before you conclude that I have completely lost it, I would explain that this put me in mind of *In re Brown & Root McDermott Fabricators Application* [1996] STC 483 (come on, you remember that) where the Court had to give consideration to the doctrine of rescission. His Lordship considered that the relevant reasoning in determining the issue was found from the Rubaiyat of Omar Khayyam and quoted Quadrain 51:

> *"The Moving Finger writes; and having writ,*
>
> *Moves on: nor all thy Piety nor Wit*
>
> *Shall lure it back to cancel half a Line,*
>
> *Nor all thy Tears wash out a Word of it".*

I recall at the time not being convinced that this was an appropriate legal analysis but clearly poetry (and in particular, the Rubaiyat) is more important than I thought.

Retirement Benefits

The recent case of *Forsyth v HMRC TC 4029* looks straightforward on the face of it - but the more you look at it, the less simple it seems.

Mr Forsyth retired from Nestle and following his retirement he continued to benefit from the company's healthcare scheme.

In 2009 the company offered Mr Forsyth the opportunity to leave the healthcare scheme in return for a one off payment of just under £30,000. He took the money.

Among other things, Mr Forsyth claimed that this should be treated as a payment on the termination of his employment and not be subject to tax because it was under the £30,000 limit provided by section 401 ITEPA 2003.

The Tribunal drew attention to section 401(3) which said that the £30,000 exemption did not apply to any payment or benefit chargeable to income tax under other provisions.

The Tribunal considered that the payment under the compromise agreement was a "relevant benefit" from an Employer Financed Retirement Benefit Scheme under Section 393 ITEPA. It was chargeable to tax under Section 393 and was therefore excluded from the £30,000 exemption in section 401.

However, I have been (respectfully) wondering about this. It seems to me that when Mr Forsyth retired he had a non cash benefit which would no doubt have been brought into account by reference to its cash equivalent and covered by the £30,000 exemption at the time. That is what happens with non cash benefits which continue (or are provided) following the termination of an employment.

If for example on his retirement he had used up his £30,000 exemption elsewhere then the cash equivalent of the healthcare benefit would have been charged to tax. It could not then be right for a payment for the surrender of that right for a lump sum (no doubt broadly equal to the cash equivalent) to be brought into charge to tax again.

Furthermore, an Employer Financed Retirement Benefit Scheme is a scheme for the provision of *relevant benefits*. A relevant benefit for this purpose includes a lump sum or other benefit provided after the retirement of the employee in connection with past service.

The Tribunal decided that the lump sum was paid in connection with his past service and was therefore a relevant benefit. Accordingly it fell within Section 393 which trumped Section 401 and it was fully taxable. However, surely the benefit was the provision of the healthcare (or the cash equivalent thereof); the lump sum would not seem to have been a benefit at all, and so I wonder therefore how this analysis works.

Qualifying Corporate Bonds

The recent case of *Trigg v HMRC TC 4079* is an object lesson in how something apparently benign and entirely commercial can have seriously adverse tax consequences – the reasons for which defy common sense.

The issue related to whether some corporate bonds were QCBs on non QCBs – which have markedly different treatment for capital gains tax.

One of the features which disqualifies a corporate bond from being a QCB is if it contains a provision "for conversion into, or redemption in, a currency other than Sterling".

The corporate bonds with which Mr Trigg was concerned contained some precautionary drafting to deal with the position if the UK joins the Euro and Sterling disappears. If there were to be a change in the currency of the UK then there would be a conversion into the new UK currency at the official rate provided by the Bank of England, and the corporate bonds would be redeemed in the lawful currency of the United Kingdom. You can hardly blame anybody for including such precautionary wording (legal documents always contain loads of wording which is merely precautionary) – although on one view, it may not have been necessary at all. It seems rather unlikely that if the UK were to join the Euro, all obligations expressed in Sterling would no longer be enforceable.

Anyway, HMRC said that this meant that the corporate bonds were disqualified from being QCBs.

HMRC looked to have a really good argument. The bond clearly had a provision for redemption in another currency. Mr Trigg tried to argue that Sterling should be given the meaning of "the lawful currency of the UK from time to time" but the Tribunal did not feel that was a permissible interpretation and that Sterling meant British Pounds. Euros, even if they were adopted as the lawful British currency, would not be British Pounds.

However, Mr Trigg also argued that the phrase "currency other than Sterling" involved a necessary requirement that Sterling continued to exist as a separate currency. In the case of Mr Trigg's corporate bond, the point at which the bonds were converted into Euros would be the point at which Sterling did not exist. At the time that the lawful currency unit of the UK became the Euro, the bond would automatically be converted at the rate of exchange provided by the Bank of England for the purpose.

Section 117(2)(b) TCGA 1992 specifically disregards a provision for redemption in a currency other than Sterling at the rate of exchange prevailing at redemption.

Of course, if the UK joined the Euro and Sterling disappeared there could be no rate of exchange at the date of redemption. The Tribunal took the view that it did not matter whether they were converted before rather than at the moment of redemption as long as their Sterling value is unchanged – Parliament cannot have intended to draw such a pointless distinction. The Tribunal concluded that there was no provision for conversion or redemption in a currency other than Sterling and in any event the exception in Section 117(2)(b) applied because although there was provision for redemption in another currency, it was at the rate of exchange prevailing at redemption.

HMRC suggested that such an interpretation would be contrary to the general understanding (by which I suppose they mean their understanding) but the Tribunal made it clear that there is no rule of construction that legislation should be interpreted with HMRC's understanding – or the understanding of tax advisers for that matter.

A triumph for common sense I think – but it was obviously touch and go.

Entrepreneurs Relief

One of the conditions for the application of entrepreneurs relief is that the individual must be an officer or employee of the company throughout the period of one year ending with the date of the disposal. This condition was recently given exhaustive examination by the Tribunal in *Hirst v HMRC TC 4038*.

Mr Hirst had been a director of the company, but he had ceased to be a director prior to the sale. Accordingly, if he was going to obtain entrepreneurs relief, he needed to demonstrate that he was either a de facto director or a shadow director or an employee. The Tribunal decided that he was not a de facto director within Section 250 Companies Act 2006 being "a person occupying the position of director by whatever name called". The Tribunal said that Mr Hirst's influence in the corporate governance of the company was commensurate with, but limited to, that of a significant shareholder.

Mr Hirst might have been a shadow director within the meaning of Section 251 being "a person in accordance with whose directions or instructions the directors of the company are accustomed to act". Again, the Tribunal found that Mr Hirst did not direct or instruct the board how to act. His influence was commensurate with, but limited to, that of a significant shareholder.

However that was not the end of the matter. The Tribunal considered whether Mr Hirst had continued to be an employee. This looked a bit difficult because he did not seem to do anything nor was he being paid. However, Mr Hirst had agreed with the company that he would be entitled to commissions for the introduction of new business (no commissions were ever paid) and the company continued to provide him with a phone, a laptop and they paid for his home internet. The Tribunal concluded that this was enough to constitute an employment relationship which continued until the date of disposal.

It was the view of HMRC that although there are no specific requirements regarding hours or work or level of remuneration, there had to be some remuneration for an employment to exist. This would seem to be arguable. Although remuneration would normally be the consideration for the services performed, it is easy to envisage a contract for the performance of services involving consideration which could not be categorised as remuneration. This point was not addressed by the Tribunal – but it did not need to be because they found that the agreement regarding the commission and the provision of "non cash remuneration" being the provision of assets for the use of Mr Hirst was sufficient.

This would seem to be a generous decision and it will be interesting to see whether this goes further.

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