UK Tax Bulletin

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Latest Rates of Inflation and Interest

The following are the current rates at January 2015

Current Rates	January 2015
Retail Price Index: December 2014	257.5
Inflation Rate: December 2014	1.6%
Indexation factor from March 1982: to November 2014 to December 2015	 2.236 2.241

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%

Trading Losses : Horse Racing

The Tribunal has recently considered a claim for relief in respect of a loss incurred from horse racing : *McMorris v HMRC TC 4204*.

In many ways Mr McMorris' claim looked quite promising. He was knowledgeable about horses and horse racing and an opportunity arose for him to become involved in horse racing with a third party by their acquisition of a horse and the funding of all the relevant expenses. He did considerable research into the horse's pedigree, took appropriate advice and went ahead on the expectation that with proper professional training, the horse would win races and be sold at a profit.

One can easily understand why Mr McMorris regarded this as an adventure in the nature of trade – and he would surely have felt that his view was vindicated when the horse did well and a substantial offer was received from a prospective buyer to buy the horse.

Unfortunately however (you can see this coming) they decided not to sell but to continue in the hope that a higher offer would be forthcoming. Of course it all went wrong and after a comparatively short period, the horse was sold for virtually nothing.

Mr McMorris did not regard the activity as a hobby but as a serious, well researched business operation (registered for VAT) which represented an adventure in the nature of trade. Accordingly, he claimed that the loss he had sustained on the horse racing operation amounting to approximately £12,000 should be allowable as a trading loss against his other income.

HMRC did not agree because their long standing practice, and their firm view, is that horse racing is not a taxable activity. Accordingly, any winnings from racing are tax free and so would the profit on the sale of the horse (had it taken place). It follows that any losses would not be allowable.

HMRC have lots of support for their view with the courts routinely acknowledging (if not expressly deciding) that horse racing is not a trading activity – even though in 1942 in *Benson v Counsell 24 TC 178* it was held that sending a horse to be trained, raced and sold after racing was a taxable business.

This is to be contrasted with the operation of a stud which is a taxable activity. Where a stud farm also races horses, the division between the two activities has to be clearly identified and any movement of horses from the stud activity to the racing activity must take place at market value. This was the whole basis of the House of Lords decision in *Sharkey v Wernher 36 TC 275*.

However, Mr McMorris may have felt that his circumstances were sufficiently strong to overturn these long established principles – but I fear it would have meant a crusade because had he been successful, a trip all the way to the Supreme Court may have been inevitable.

Non Statutory Clearances

HMRC has published a new Manual on the subject of non statutory clearances. This is not quite as exciting as it seems because the new publication really only collates the existing practice into a single Manual. In August 2013 they combined the non statutory business clearance guidance with the inheritance tax and CAP1 guidance to create the "Other Non-Statutory Clearance Guidance" which is the name of the new Manual.

The idea continues to be that a taxpayer can obtain HMRC's view of the tax consequences of a transaction where they have fully considered the relevant legislation and guidance but remain uncertain about HMRC's view.

This is a really valuable service because identifying the view of HMRC can often be a tad difficult,

requiring considerable patience and sometimes a degree of wisdom that passeth mortal understanding.

However, the scope is a little more restrictive than one might imagine. It only applies to recent tax legislation and will not apply to the substantial volume of draft legislation and other explanatory notes which are published in advance for information and consultation. There will be no additional guidance until such time as the legislation is in force.

It is specifically confirmed that a taxpayer can rely on a non statutory clearance obtained from HMRC. (They say "in most circumstances" but it is expected that reliance would only be denied in cases where there has been misrepresentation or a lack of full disclosure).

HMRC make it clear that notwithstanding the receipt of HMRC's view following a clearance application, the taxpayer is still entitled to act on the basis of their own view and to self assess their liability accordingly.

Travel Expenses : Local Authorities

I was (sort of) amused to read the draft regulations published last week which give a tax exemption for travel expenses of members of local authorities.

Everybody knows about the incredibly restrictive rules for the deduction of expenses from employment income, and travelling expenses in particular. It seems that members of local authorities are seized by the unfairness and you might have thought that this might have encouraged somebody to address this unfairness. Unfortunately not. The solution was for the Treasury to grant an exemption to members of local authorities so they are not subject to these rules. I think that the Treasury special adviser (B Assad Esq.) has explained that it is OK to pass laws which are unfair and burdensome, as long as they do not apply to us.

I do not want to get carried away but in this Magna Carta year one might wonder about the wisdom of passing laws to exempt those in power from laws which apply to everybody else.

For those who think I am making too much of this, I would recommend a read of the Income Tax (Travel Expenses of Members of Local Authorities) Regulations 2015.

CGT : Contingent Liabilities

The recent Court of Session judgment in *Morrison v HMRC [2014] 113* might give you a fright.

Mr Morrison had sold his shares in Morrisons Plc at a capital gain in 2000/01. Some time later the purchaser bought an action for damages against Mr Morrison claiming that he had misrepresented the profitability of the company at the time of the sale. The action was eventually settled by the payment of £12 million and Mr Morrison claimed a deduction by way of adjustment to the calculation of his capital gain in 2000/01.

The general rule regarding such computations in Section 48 TCGA 1992 is that in calculating the gain:

> *“The consideration for the disposal shall be brought into account without any discount for postponement of the right to receive any part of it and, in the first instance, without regard to a risk of any part of the consideration being irrecoverable or to the right to receive any part of the consideration being contingent.”*

This general rule is modified by Section 49 which provides that where a contingent liability

subsequently arises and is enforced, an adjustment can be made to reduce the capital gain.

HMRC denied the deduction on the grounds that the settlement payment was not part of the consideration for the sale. They said that the liability was not directly referable to the value of the consideration received by the taxpayer on the disposal of his shares.

The Court of Session took the view that for this purpose, a contingent liability is a liability which depends for its existence upon an event which may or may not happen – and includes liabilities which emerge after the disposal but arise as a consequence of a state of affairs existing at that time.

The Upper Tribunal had suggested that the liability had to be incurred by the taxpayer in his capacity as seller, on the disposal of the asset concerned and had to be relevant to the computation of the gain in that it reduced the value of the consideration received on the sale of the asset.

The Court of Session did not necessarily agree that these were the right tests but they concluded that Mr Morrison satisfied them anyway. They held that the representations made by the taxpayer (which gave rise to the claim) were made on the disposal of the shares and the reality of the payment was that it reduced the gain made on the disposal.

Although the Court of Session was clear on the principles involved here, an uncertainty arose because they found it necessary to remit to the First Tier Tribunal the question of how much of the payment was referable to the representations made and whether part of the payment had been in respect of other matters.

It is not easy to ensure that every conceivable contingency which might give rise to a settlement payment can be attributed to the sale – particularly in the face of HMRC's argument that such a payment is not a contingent liability at all but a payment for a completely different reason. Indeed, Mr Morrison had not been sued in contract, but in tort. Although the Court of Session found for Mr Morrison, it is clear from the decision of the Upper Tribunal, that this could so easily have gone the other way.

VAT Penalties

It is clearly my month for being sympathetic. I have been reading the case of *Sam Smith v HMRC TC 4237*. Captain Smith was a helicopter pilot who carried on a VAT registered business. He had discussions with HMRC regarding the deduction of input tax on some expenses. The VAT officer advised that they were disallowable. Captain Smith did not agree and said that he would include the input tax on his VAT return so that he would be able to appeal against the VAT position taken by HMRC.

The response of HMRC was to say that his return was a false or inflated claim to a repayment of tax and he was therefore liable for a penalty. Worse still Captain Smith had made an active choice to claim VAT "that he had been advised was not claimable" and it was therefore a deliberate false claim giving rise to a higher penalty.

Pausing there for a moment, one might wonder how a taxpayer is supposed to make a claim to input tax. They must claim it on their return – there is no other way. Obviously, they do it deliberately – to suggest otherwise is absurd. If HMRC disagree then the procedure is for the matter to be heard by the Tribunal for adjudication. As far as I was aware, just disagreeing with the advice of HMRC did not make you liable to a penalty.

Actually, Captain Smith (and his accountant) were wrong. The rules did not allow an input tax deduction for the amount he was claiming – but I cannot see that makes any difference. It was not a vexatious or frivolous claim.

Nevertheless, the Tribunal confirmed the penalty.

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The only conclusion that can be drawn from this case is that if HMRC are able to disallow any input tax, you must be liable to a penalty. You must have deliberately made the claim (you cannot say that you did not deliberately make the claim, otherwise you would be careless, and culpable on that ground) and the claim must inevitably be excessive. This surely cannot be right .

One gets the feeling from the judgment that the Tribunal was not entirely comfortable with this penalty but concluded that unless they could say that the input tax was allowable or that Captain Smith had not made his claim deliberately, there was nothing they could do.

I think that something is not quite right here.

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