UK Tax Bulletin

February 2015

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Latest Rates of Inflation and Interest

The following are the current rates at February 2015

Current Rates	February 2015
Retail Price Index: January 2015	255.4
Inflation Rate: January 2015	1.1%
Indexation factor from March 1982: to December 2014 to January 2015	 2.241 2.215

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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GAAR

On 30 January HMRC published some new guidance regarding the General Anti Abuse Rule (approved by the Advisory Panel). It goes for 191 pages. I thought it might be a kindness to mention that it is virtually unchanged from the guidance issued in April 2013. The wording has been tidied up and there is a new example dealing with an abusive arrangement (example D25A) relating to disguised remuneration and Part 7A of ITEPA 2003. There is also a new section on national insurance contributions to which the GAAR was extended in March 2014. Everything else is pretty much the same … well, nearly.

A new passage has been included at B.13 to explain that in deciding whether an abusive transaction has taken place, HMRC will not just be looking at an alternative transaction the taxpayer might have adopted to achieve the same result; they may also compare it with the position if the taxpayer had done nothing at all.

So a taxpayer may do something and then be taxed as if he had done nothing at all. This sounds a bit worrying as it is surely only a short step from saying that a taxpayer who does nothing can be taxed as if he had done something.

Actually, this is not all that far from the position with SDLT and the operation of Section 75A where SDLT can be charged on the basis of an alternative notional transaction (i.e. one which did not happen) but which would have given rise to a larger liability to SDLT.

None of this is likely to be welcomed by those who are keen on the Rule of Law.

It is always good to have official guidance – although I wonder why it was really necessary to issue this now with so few changes, particularly as I do not believe there have yet been any notices issued by HMRC requiring a reference to the GAAR Advisory Panel.

Goodwill

The existence and valuation of goodwill continues to engage lots of attention and the recent case of *Spring Capital Limited v HMRC TC 4276* adds some helpful commentary.

The case was all about whether goodwill acquired by a company could be deducted to create a trading loss - and although that would have been extremely interesting, the Tribunal found that on the evidence, the purchase of the goodwill did not actually happen. However, the Tribunal went on to consider how the goodwill should have been valued had the transfer actually occurred.

One element of the judgment is particularly unfortunate. The taxpayer complained because the Tribunal had made a specific direction regarding independent experts but the expert witness put forward by HMRC was not independent; she was an employee of HMRC. Furthermore she had been instructed with the words "a witness statement from you would assist our case". The Tribunal Judge said that HMRC's failure to comply with the directions fell below the conduct expected of a Government department. However, the Tribunal concluded that it did not make any difference and her evidence would be given exactly the same weight as the independent witness of the Claimant.

What possible incentive is there for parties to adhere to the directions of the Court if they can ignore them completely with absolutely no detriment whatsoever.

Anyway back to the issue. Both experts agreed that the value of the goodwill should be found by valuing the business as a whole and then deducting the net assets.

One of the key points was that the business in question depended almost entirely on the continued efforts of two of the directors and shareholders. It was generally acknowledged that if they were to leave, then the business would be worthless. For this reason it was suggested that the value of the business as a whole was practically nothing.

However, the Tribunal concluded that in determining the value of the business it was reasonable to assume that the two gentlemen would remain with the business and that employment contracts and non competition covenants would have been entered into. The authority for this approach derived from *IRC v Gray (Executor of Lady Fox Deceased) 1994 STC 360* that the vendor must be supposed to have taken the course which would get the largest price for the asset providing it did not entail undue expenditure of time and effort.

This is an interesting judgment which may have wider implications. However it would perhaps have been possible to approach the issue on general principles. We could consider the value that a willing vendor and a willing purchaser would place on the goodwill in the hypothetical transaction that we are obliged to consider in fiscal valuations - and that might very well have ended up with the same conclusion.

Tax Schemes - Professional Obligations

In a funny sort of way it is rather pleasing that the only governmental statement that makes any sense in this interminable tax avoidance confusion comes from HMRC. They have explained that they have been doing their job, collecting the tax according to the law, and adhering to their legal obligations with other countries. I expect they rather resent being subject to so much criticism by politicians who would seem to prefer HMRC to abandon the law in pursuit of their various political agendas. I have little doubt that the Courts will stand equally firm and disregard ill informed political sound bites - and indeed this seems to be the position (see further below).

Another dimension to this issue was revealed earlier this month in the case of *Altus Group (UK) Limited v Baker Tilly* which in broad terms involved a claim by Altus that their advisers had been negligent in failing to advise them on a tax avoidance scheme.

(We have been here before. You may remember the case of *Harben Barker* - see March 2014 Bulletin - where the accountants were held to be negligent for not implementing a tax avoidance scheme, although they were mercifully saved by the Court of Appeal).

The Court said that whether there is a breach of duty is determined by considering whether there was the loss of a chance. The Claimant had to show that it would have taken a certain advantageous course of action (in this case, entering into a tax scheme) and the Court must assess the chance that the course of action would have been successful.

The Court decided, on the facts, that if the claimant had implemented the scheme there was a real and substantial chance that it would have been successfully challenged by HMRC. That is a comfort - but it seems from the judgment that if the tax avoidance scheme would probably have been successful, the advisers would have been seriously at risk.

An interesting and topical argument was advanced by the defendant:

> *"Artificial tax avoidance is a social evil which puts an unfair burden on the shoulders of those who do not adopt such measures - per Pitt v Holt. This and the taxpayer's duty to pay tax mean that it is contrary to public policy to permit a taxpayer to recover damages for loss of the opportunity to pay less tax than would have been properly payable."*

His Lordship did not regard this argument as persuasive.

Trading or Investment

This perennial question appeared again recently in the case of *Terrace Hill (Berkeley) Limited v HMRC TC 4282*. The taxpayer was involved in the development of an office property and the question arose whether this was a trading activity or an investment. This is a familiar issue and the Tribunal said the question was finely balanced but ultimately found in favour of the taxpayer that the property was purchased as an investment.

The issue was one of fact. When the property was acquired was it intended to be retained as an investment – or was it intended to be sold immediately for the best possible price?

The facts were long and complicated but the essential elements which persuaded the Tribunal that the acquisition was an investment and not trading were as follows:

a) The accounting treatment of the property was as a capital asset – and not as trading stock;

b) A claim for capital allowances had been made which could only have been possible it if was an investment;

c) The evidence before the Tribunal was that at the point of acquisition the property was intended to be an investment;

d) The documentation was (mainly) consistent with an investment;

e) The sale was motivated by a disappointing rental performance combined with an extremely attractive offer to sell.

A disturbing feature of the decision is that HMRC sought to impose a penalty of £1 million on the grounds that by claiming that the disposal was of an investment asset, the taxpayer was negligent.

HMRC are presently consulting on the question of penalties and how the system can be improved. They should start here. The proposition that merely expressing a view contrary to HMRC's view is deserving of a penalty looks rather extreme – but there is nothing in the judgment to indicate how this could be regarded as reasonable. (I thought the penalty imposed on Sam Smith for daring to challenge HMRC before the Tribunal referred to last month was an aberration– but this is beginning to look like policy).

Fortunately, the Tribunal found that the taxpayer had not been negligent – indeed he had been quite correct, and they confirmed that even if he had been wrong he had not been negligent in dealing with the matter in this way.

Penalties

The issue of penalties also arose in the case of *Herefordshire Property Company Limited v HMRC TC 4286*. This time it was on the theme of reliance on a professional adviser.

The taxpayer entered into a tax scheme to generate a capital loss similar to that which failed in *Drummond v HMRC* in 2009 and following the Court of Appeal decision in that case, the taxpayer withdrew his claim for a capital loss and paid the tax.

The issue in this case was that HMRC immediately imposed a penalty claiming that they were negligent in submitting their tax return in the manner they had been advised. The test of negligence, reiterated by the Tribunal, is essentially whether the Appellant failed to do something that a reasonable taxpayer would have done, or did something that no reasonable taxpayer would have done.

HMRC claimed that the taxpayer should have sought further independent advice in relation to the efficacy of the scheme. It was apparent that HMRC did not think it was reasonable for the taxpayer to have relied on the firm advising them regarding the matter. The Tribunal thought that it was quite reasonable for the taxpayer not to have done so.

A more bizarre argument was that HMRC claimed the taxpayer was negligent because their tax return should have reflected the expectation that the scheme would fail. I can hardly think of a more unreasonable argument. The taxpayer engages professional tax advisers, he understands the transaction, is advised by the tax advisers that it is effective, he reads an opinion from Tax Counsel and reflects all the relevant matters on his tax return as he has been advised. Can it seriously be suggested that he should then include on his tax return a statement that "I expect this tax scheme to fail and should not be entitled to the loss that I have claimed"?

It is no surprise that the Tribunal had no hesitation in dismissing any suggestion that the taxpayer had been negligent.

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