SQUIRE PATTON BOGGS

UK Tax Bulletin

April 2015

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Introduction

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Latest Rates of Inflation and Interest

The following are the current rates at April 2015

Current Rates	April 2015
Retail Price Index: March 2015	257.1
Inflation Rate: March 2015	0.9%
Indexation factor from March 1982: to February 2015 to March 2015	 2.231 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%

To 6 April 2015: 3.25%

From 6 April 2015: 3%

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Non doms - what is going on?

I read with interest Mr Miliband's proposal to abolish non-dom status although I think he was rather overstating the position. The concept of domicile is not a creation of HMRC – it is a matter of international law and feeds into many areas of law such as the validity of a marriage, the forum for divorce, legitimacy and the entitlement for dependants to claim from the estate of a deceased person. However, it is also part of our tax code which is specifically designed so that foreign people who are in the UK only pay tax on their UK income and assets and not on their foreign income and capital gains unless they enjoy them in the UK.

This cannot sensibly be categorised as a loophole by any stretch of the imagination. It is exactly how the law has always been intended to work – and the UK has benefitted very substantially as a result. Mr Miliband suggests that the UK is unique taxing people on this basis but this is simply wrong. Many other countries do it, but just have a different name for it; they say they are taxing people on local source income and not on foreign income.

Mr Miliband wants to sweep away all the tax benefits available to non-doms so that they pay tax on their worldwide income and gains just like all other UK residents. He says that people who have made the UK their permanent home and are permanently settled in the UK should not be entitled to claim these benefits - so he is going to put a stop to it.

There is some misunderstanding here because by definition a person acquires a domicile of choice here if they reside in the UK and intend to reside here permanently or indefinitely. So, many of those people to whom Mr Miliband refers will already be UK domiciled.

This is all politics of course but regrettably the politicians of all colours seem to have become obsessed by the sound bite rather than the substance. It would help to have some relationship between the two; actually, any would be nice.

There has been a lot of nonsense written about this subject in recent weeks and it is very regrettable that HMRC are being portrayed as so gullible that they would accept people as having a foreign domicile on flimsy (if any) grounds. The idea that somebody can establish (or retain) a foreign domicile by reason of a newspaper subscription or burial plot is just laughable. Anybody with any experience of dealing with HMRC on domicile matters will know that they are extremely knowledgeable and very tenacious, sometimes requiring a rather higher standard of proof that may strictly be necessary.

At the risk of boring everybody's socks off, some basic principles may help to put this matter into perspective:

(a) A domicile of origin is that acquired at birth. A legitimate child takes his domicile of origin from his father; an illegitimate child takes his domicile from his mother. This is the default position. A domicile of origin is never really lost; it goes into a kind of limbo if another domicile is acquired, ready to be revived when that other domicile is lost.

(b) A domicile of choice is acquired as a matter of law by the combination of residence in a territory and the intention of permanent or indefinite residence there – but not otherwise.

(c) A domicile of dependence arises if the relevant parent's domicile changes before the child reaches the age of 16. The child's domicile of dependence is then converted into a domicile of choice which is retained or lost by reference to his own circumstances.

(d) A deemed domicile arises (applicable for inheritance tax only) where an individual has been resident in the UK for 17 out of the previous 20 years.

There is a substantial and established body of law regarding the concept of domicile and the idea of sweeping centuries of legal precedent away in the hope of a good sound bite seems a bit disproportionate to me.

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Non Residents CGT

We now have the non residents capital gains tax in place and I think we can be sure it will never go away. Taxes rarely do (although I do remember Development Land Tax being abolished in 1985).

Most non residents who have an interest in a UK residential property will now be liable to capital gains tax on its disposal. This might catch out a few non residents because it will also apply on a disposal by way of gift and deemed disposals. We know all about those concepts here, but they might come as a shock to some foreign owners who are unfamiliar with the principles of UK tax.

However, the tax will only be chargeable on the increase in value from 6 April 2015. This will be done either by rebasing or by an election for time apportionment.

HMRC recommend a professional valuation at 6 April 2015 but there are serious doubts whether this is worthwhile. HMRC will do their own valuation anyway and if you have a contemporaneous professional valuation that does not in my experience cut any ice with them at all. (Although it may help you avoid a penalty if there is a serious dispute later on).

These days, all property transactions are able to be found on the internet so it should not be a problem because the value can be identified a long time after the event by reference to similar transactions in the same vicinity at the same time. After all, that would be the basis for a professional valuation too. (I am not quite sure about the extent of judicial notice here : "it's Zoopla my Lord, innit".)

If there is some reason why the property is worth more than normal, perhaps because of some special feature which might be lost in the mists of time, clearly some contemporaneous evidence of these factors would be sensible.

We are still no clearer about how this tax is going to be collected. HMRC explains that the foreign resident, having sold the property will subsequently submit a self assessment tax return and pay the tax. This looks a bit optimistic – although the increased international cooperation over tax matters now means that recovery action might not be too difficult for HMRC in many cases. We have come a long way since the *Government of India v Taylor (1955)* and the principle that the courts of one country will not enforce the tax debts of another. Double Tax Treaties, the OECD Convention on Mutual Administrative Assistance and the EU Directive 2010/24/EU in 2010 may give HMRC all they need to collect the tax if somebody is a bit slow in getting round to it.

Agreements with HMRC

I think that HMRC are getting an unjustifiably bad press at the moment – but they do not help themselves with cases like Southern Cross : *HMRC v Southern Cross Employment Agency Limited [2015] UK UT 0122.*

The case related to VAT on the supplies of dental nurses and a claim for input tax deduction by Southern Cross. After a period of negotiation with HMRC a compromise was reached whereby HMRC agreed to make a repayment of approximately £1.4 million.

There is no suggestion that either side acted in any way improperly or withheld any relevant information. This was a perfectly normal professional negotiation – the sort which happens every day all over the country.

However, HMRC subsequently decided that this was not a good deal after all and tried to get out of it by saying they had no power to come to any agreement so it was all null and void. Can we have our money back please?

What could they have been thinking? The reputational damage to HMRC by taking such a stance must be colossal. We will negotiate an agreement with you knowing that we did not have power to do so and then go back on it if we change our mind later….

The First Tier Tribunal threw out HMRC's claim and so did the Upper Tribunal. A public body simply cannot behave like this. However, what really matters is that they tried to do so. And can you imagine the chaos and outrage that would have ensued if they had succeeded – not just for HMRC but numerous other public bodies.

The arguments do not matter because this is not a question of legal argument; it is a matter of honourable conduct – or dishonourable conduct. HMRC can hardly claim any moral high ground if they behave this way. At least if they raise this argument again, the taxpayer has some pretty strong statements from the Upper Tribunal (which after all is a Court of Record with the precedential status of the High Court) to help them.

Inheritance Tax : 10 year charge

The recent case of *Seddon v HMRC TC 4344* was mainly about whether a scrip dividend received by the trustees of a discretionary settlement (and subsequently distributed to beneficiaries immediately prior to the first tenth anniversary of the settlement), represented relevant property subject to an exit charge.

I do not suppose this will strike anybody as particularly interesting – it does seem a little obscure although not so obscure as to prevent Ministerial time being found in the Finance Act 2014 to introduce Section 64(1A) IHTA 1984 to the effect that income arising to the trustees which has not been distributed for five years is deemed to be capital and subject to the ten year and exit charges.

The main question in Seddon was whether the scrip dividend was income or capital in the hands of the trustees and this gave rise to an interesting discussion about the respective status of the Upper Tribunal and the High Court. This was relevant because a previous decision of the High Court suggested that a scrip dividend was income for trust law purposes and therefore outside the scope of the relevant property regime. However, the Upper Tribunal subsequently decided that a scrip dividend was capital in the hands of the trustees. It was explained in detail that as a matter of stare decisis, the Upper Tribunal being a superior Court of Record, is not bound by High Court decisions – although the High Court does have a supervisory jurisdiction as a matter of Judicial Review over unappealable decisions of the Upper Tribunal.

The First Tier Tribunal decided that they were bound by the later decision of the Upper Tribunal that the scrip dividend was capital in the hands of the trustees for the purposes of inheritance tax and it therefore formed part of the calculation of the exit charge.

Although this conclusion was decisive, the FTT also considered the position in the event that the scrip dividend had been regarded as income.

The general rule is that the undistributed income of the trustees is not relevant property for inheritance tax purposes, but if the income is accumulated, it becomes capital and therefore within the scope of inheritance tax. This was clearly acknowledged by HMRC in their Statement of Practice SP6/86. The question was whether in the absence of an express accumulation by the trustees, the income had in fact been accumulated. The onus was on the trustees to show that the income had not been accumulated and they were unable to discharge this burden, so the charge to inheritance tax would have arisen anyway.

So where income has been accumulated the position is clear, although it places a responsibility on the trustees to demonstrate whether they have accumulated the income or not. However, that is no longer the end of the story because where income has not been accumulated expressly by the trustees and merely remains undistributed, the terms of Section 64(1A) provide that after five years it will be deemed to have been accumulated. Unfortunately this causes a rather ambiguous

position because the income would be treated as accumulated for inheritance tax, it would not be treated as accumulated for trust law purposes (or for income tax) and this is likely to cause more than an average amount of confusion.

QROPS

The transfer of pension pots to a Qualifying Recognised Overseas Pension Scheme has been a source of confusion and anxiety for some time. If someone is living abroad, there are obviously some good reasons why they might want their pension scheme to be outside the UK and not subject to the restrictions (and taxes) which apply to UK schemes. They may reasonably prefer to be subject to the rules (and taxes) applicable to their local jurisdiction.

Unfortunately, you cannot just transfer you pension scheme to any old overseas scheme – because unless the transfer is "authorised" it carries a 55% tax charge and a series of penalties. You have to transfer it to a QROPS. So how do you know it is a QROPS? This is rather important because of the serious consequences of getting it wrong. HMRC will not confirm it (at least not in a way you can rely on) but they do publish a list of QROPS on their website – and providing you checked the web site immediately (like within 24 hours) before making the transfer, you could be sure that everything is OK.

Well not any more. They have a new disclaimer on their QROPS website which says they do not guarantee that any pension scheme on the list is a QROPS so a transfer to a pension scheme on the list is at your own risk of tax - and penalties. They say it is your responsibility to find out whether it qualifies or not. Er, the purpose of HMRC publishing a list is what, then?

And how on earth are you supposed to find out? How about asking HMRC. Great idea – except that they won't tell you. You can take advice - but what if HMRC do not agree (maybe years later) and charge you 55% tax and a 15% penalty. That is your life savings gone – anything left will be eaten up by legal costs fighting such a charge. Who in their right mind would take such a risk when there is such uncertainty over whether any tax is payable.

I do not think this fits very well with the HMRC Charter which says:

> *"We want to give you as much certainty as we can that you are paying or claiming the right amount*."

It does not look like they want to do anything of the sort.

So what can you do? Goodness knows - although I guess that finding a QROPS in a jurisdiction where HMRC has already accepted lots of transfers is probably a good start.

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