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UK Tax Bulletin

July 2015

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Introduction

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Latest Rates of Inflation and Interest

The following are the current rates at July 2015

Current Rates	July 2015
Retail Price Index: June 2015	258.1
Inflation Rate: June 2015	1%
Indexation factor from March 1982:	
to May 2015	2.254
to June 2015	2.259

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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Finance Bill

The Summer Finance Bill was published on 15 July and provides further details of the Budget proposals. Not everything of course because some important bits (like the non dom changes and inheritance tax) are going to be the subject of consultation in the autumn. However some further information on these topics is included below.

Non Doms

You have to laugh.

We all know about non doms. The politicians and the newspapers never tire of telling us that non doms do bad things for our economy and our country and the sooner we put all their heads on a spike the better off we will be.

It is therefore interesting to read that Cyprus has just announced the introduction of a new concept of domicile which will revive the country's economy, attract foreign investment and generally do all manner of good things to the financial position of Cyprus.

They obviously don't know nuffink.

Non Dom Rules

Excluded Property: UK Residences

From April 2017 UK residential property held directly or indirectly by a foreign company will come within the scope of IHT – and not be protected by the excluded property rules which apply at the moment. The charge will apparently be based on the ATED rules (but with none of the reliefs or exemptions).

It is sometimes suggested that these changes will involve a look through to the underlying residential property held by the company. This is a convenient shorthand but it is not really the case. It is the shares which will be disqualified as excluded property – which is why HMRC are needing to consult on what to do about the other assets owned by the company which would not be caught by these new provisions. There is also the issue of what to do when the property is not wholly owned by the company.

It is necessary to consider when and how this charge will arise. Obviously it will apply on death but it will also apply to gifts during lifetime which might be PETs and if a trust is involved, there will be exposure to the ten year and exit charges.

At the moment the excluded property rules trump the gift with reservation rules. Accordingly, a transfer of foreign shares to a trust would not be a chargeable transfer and nor would the fact that the individual is a beneficiary of the trust be of any significance if the trust assets are excluded property. If however the trust assets are not excluded property, there will be a chargeable transfer of the shares into the trust, and there will be a ten year charge, and the UK property would remain in the estate of the individual because of the reservation of benefit. I know that HMRC are keen to ensure that non-doms pay loads of tax – but three charges sounds a bit much.

And of course they have made it clear that DOTAS will apply if a scheme is implemented to avoid this charge to IHT – and the GAAR will apply as well.

For existing trusts which hold companies owning UK residential property clearly some action needs to be taken before April 2017 to protect the individual from these multiple charges. This will not necessarily be very easy and it looks like we will be dealing with the same type of issues that arose when de-enveloping for the ATED.

It is interesting to consider the position of an existing discretionary trust for the benefit of the settlors' children which holds shares in a foreign company with a UK residential property. Such shares will no longer be excluded property but if the settlor is excluded from benefit there would be no GROB and no charge to tax on his death. However, there will be the ten year charge and exit charges if the shares are taken out of the trust after 2017 so this may encourage a distribution of the shares prior to 2017.

UK Domicile of Origin

The proposal is that somebody with a UK domicile of origin who has acquired a foreign domicile of choice will not be able to take advantage of the remittance basis in the event that he resumes UK residence. Indeed, he will be treated for all tax purposes as being UK domiciled, and this includes the inheritance tax treatment of trusts set up before arrival which will lose their excluded property status completely – on all assets. This seems to have rather far reaching implications.

If somebody with a foreign domicile of choice is asked by their employer to work in the UK, for a short(ish) period, they could find easily themselves UK resident after only 90 days. They would obviously have a place to live here; they would be working here for more than 40 days and in the following year they would therefore have three ties and become resident. Even worse if there were children at school in the UK. This would be a catastrophe. Such an individual would suddenly find himself chargeable to income tax and capital gains tax on his worldwide income – and then be exposed to inheritance tax for the following three years after his departure.

I cannot imagine that any sensible executive is likely to come and work in the UK under these circumstances because even a temporary posting could place him in a seriously difficult tax position. These may be issues which will be considered before all this comes into force.

15 year Rule

From April 2017 individuals who have been resident in the UK for more than 15 out of the last 20 years will be treated as deemed domiciled for all UK tax purposes. This will have a retrospective effect because it will apply equally to those who are already in the UK and have clocked up 15 years residence. If however, the individual leaves the UK and becomes non-resident before April 2017, the old rules would continue to apply to them.

A trust established before 2017 to create excluded property (obviously apart from UK residential property) may be a wise move. The old inheritance tax rules will continue to apply and they will not be taxed on any income or gains arising in the trust or underlying company – unless such income or gains are distributed, in which case they will be taxed on a worldwide basis without regard to the remittance basis.

If somebody is caught by the 15 year rule and decides to leave for five years to re-set their clock, being away for five tax year would seem to be enough. The new 15 year rule only applies when you have been resident for more than 15 years. This is suggested to be consistent with the Temporary Non Residence rules, but unfortunately it is not; for that you have to be away for more than five years.

Non-Dom charge

HMRC have announced that they will not be introducing a minimum claim period for the non-dom charges. It had been suggested that a claim to the non-dom charge would have to apply for a minimum period of 3 years to limit the scope for planning on a year to year basis. This idea has been shelved.

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Inheritance Tax: Residences

The new £175,000 inheritance tax exemption for the private residence (which starts being phased in from 2017) has lots of aspects to be considered.

It will only apply where the residence is left to children and grandchildren and not any wider family. Some difficult issues arise if the property is left in trust.

It will apply to an interest in a dwelling house which has been the individual's residence. There is no apparent correlation between this relief and the exemption for capital gains tax under Section 222 TCGA 1982 but it is very likely that the recent authorities on what represents a residence for capital gains tax will apply here.

Interestingly, the inheritance tax exemption includes "any land occupied and enjoyed with it as its garden or grounds" which is virtually identical to the wording for the capital gains tax exemption. However in contrast to the capital gains tax exemption which restricts the exemption to half a hectare, there is no such restriction for inheritance tax.

Although the Budget Day press release said that it would not apply to reduce the tax payable on lifetime transfers that are chargeable as a result of death, it is clear from the Finance Bill that the allowance will be given where the lifetime gift of the property was a gift with a reservation. In that case, the donee will still be treated as inheriting the property for this purpose and the allowance will apply.

We are no further ahead with the idea that the new relief will apply even though the deceased had downsized to a less valuable residence. Quite how this will work is a mystery – but they will publish more details in the Autumn.

Dividends

The profound change in the taxation of dividends will be a serious revenue raiser. In other words, this is a serious tax increase. Strangely, it seems that the only people who will benefit are high earning taxpayers with very modest dividends. The first £5,000 of their dividends will be exempt, whereas at the moment, they are chargeable at an effective rate of 25% or 30.6%.

It sounds like this £5,000 is good for everybody but it is no benefit at all to basic rate taxpayers. Their dividends are effectively exempt anyway because they are covered by the tax credit.

For the small business it may be pretty irritating. A husband and wife with a small business drawing salaries of £10,000 and dividends of about £30,000 each would have no income tax liability at all on their combined income of £80,000. Next year, £25,000 of their dividends will be liable to tax at the new 7.5% rate.

For higher rate taxpayers with significant dividends who were used to paying 25% on the dividends they receive are now going to pay 32.5% on everything over £5,000.

It will be even more expensive for the additional rate taxpayer who will be paying 38.1% of the excess over £5,000.

Actually when you do the figures it becomes clear that (if you ignore the £5000 exemption) everybody is going to pay an extra 7.5% tax on their dividends – whatever their tax bands. 0% goes up to 7.5%; 25% goes up to 32.5% and 30.6% goes up to 38.1%.

This is certainly going to give rise to some behavioural change. Nobody is likely to pay 20% corporation tax and then 38% on a dividend. The decisions about whether to incorporate will therefore be seriously affected and so will the interaction between salaries and dividends.

There are lots of permutations but the issue is really about how the individual can get the maximum amount in his hands with the minimum tax liability. In this equation a salary will nearly always be better than a dividend because the corporation tax relief will always outweigh the additional NIC cost.

EIS: CGT

The recent case of *Ames v HMRC* TC 4523 highlights the need for EIS income tax relief to be claimed (and obtained) before the capital gains tax exemption can apply on a disposal of the shares. Unfortunately Mr Ames did not make such a claim (it may be that he did not think it was worthwhile because he only had taxable income of £42 for the year – it is not clear from the judgement) but in any event, without an income tax claim he lost his CGT exemption. The Tribunal set the position out clearly:

> *"we agree with HMRC that the wording of the legislation means that the CGT exemption is only available if an individual's income tax has been reduced following a claim for EIS relief".*

There is not a lot of scope for argument here.

However Mr Ames tried a different approach. He said that the legislation should be read purposively because it was clear that such a capricious literal interpretation could not have been intended by Parliament. Somebody with £1 of taxable income is exempt from CGT on the disposal of the shares, but somebody with no income tax liability is denied the exemption. That did not make any sense and indeed we know that literal interpretations should give way to purposive constructions.

HMRC did not agree. They said that the legislation was perfectly clear and could not be read in any other way. That seems fair enough – although I have observed that HMRC does not accept that view when it is advanced by the taxpayer.

The Tribunal did not agree with Mr Ames. They said that Parliament had set out the legislation in a prescriptive manner and there was no room for a purpose which is not the literal meaning of the words. They drew attention to the guidance from Lord Hoffman who said that it was not for the Tribunal to rectify the terms of highly prescriptive legislation in order to include provisions which might have been included but are not actually there.

I have a feeling that we will be returning to these words in the future.

Reasonable Excuse

I make no apology for revisiting the issue of reasonable excuse because it is increasingly important to everybody.

There are so many Tribunal cases on the subject you can hardly keep track. They all have different facts – and of course everything depends on the facts. However, it is often useful to see whether the decisions of the Tribunal provide anything helpful.

In the recent case of *Barking Brickwork Contractors Limited v HMRC TC 4454* the Tribunal highlighted the view of HMRC that a reasonable excuse must be based on exceptional circumstances or an exceptional event. Absolutely not. The Tribunal said this was wrong. It is not what the legislation says. What you have to do is to consider whether the taxpayer behaved in the way that a reasonable person would behave if they wished to honour their tax obligations.

However, this may be affected by:

> "*His age and experience, his health or the incidence of some particular difficulty or misfortune and, doubtless, many other facts, [which] may all have a bearing on whether in acting as he did, he acted reasonably and so had a reasonable excuse.*"

HMRC also claimed that the taxpayer had not taken reasonable care because the answer to the issues facing him could be found in the HMRC Manuals. (An odd proposition which asks the Court to assume that everything in the HMRC Manuals is correct. This is perhaps another way of saying that if you do not agree with the view of HMRC, you are not taking reasonable care. This may seem a little extreme, but we have seen it before in the case of *Sam Smith v HMRC*).

The Tribunal did not think much of this either. They said:

> "*It cannot reasonably be assumed that a taxpayer will have read all of [the guidance]. Indeed, the very volume of the information makes it unlikely that even the most conscientious of taxpayers will have done so. Nor is it sufficient to say that a taxpayer should look for guidance on a particular matter where, as here, the taxpayer reasonably believed that they were doing everything they needed to do and they did not realise that any guidance was needed.*"

I think we may see more of this in due course, as well.

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