SQUIRE SANDERS | LEGAL COUNSEL WORLDWIDE

UNITED KINGDOM TAX BULLETIN

Squire, Sanders & Dempsey

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CURRENT RATES March 2010

Indexation

Retail price index: February 2010	219.2
Inflation rate: February 2010	3.7%

Indexation factor from March 1982:

to April 1998	1.047
to February 2010	[not published]

Interest on Overdue Tax

Interest on all unpaid tax is now charged at the same rate with effect from 29 September.

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 now 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: From 6 April 2010 4%

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The Budget

The note prepared on the afternoon of Budget Day contained the main areas likely to be of interest. There has been little of substance published subsequently, but it may be helpful to add some more information on the Budget Proposals generally.

Stamp Duty Land Tax (SDLT)

The two-year SDLT holiday in respect of the acquisition of properties up to £250,000 is rather less generous than it appeared. It only applies to first-time buyers in respect of their main residence. It does not apply to anybody who has previously acquired a property (anywhere in the world), and a joint purchase requires the test to be satisfied by both parties. Anybody who has inherited the property is disqualified. Leases of less than 21 years do not qualify.

The increase in SDLT to 5% for homes of more than £1 million would appear to be a permanent increase; it is certainly not limited to two years. However it does not come into force until 6 April 2011.

SDLT and Partnerships

The rules relating to SDLT and partnerships are notoriously complex, the tax being payable in respect of a land transaction between a partnership and one of its partners, based on the degree of connection between the parties. The anti-avoidance provisions are to be strengthened so that the SDLT will be calculated without regard to the special partnership rules.

Charitable Contributions

The definition of a charity for most tax relief requires the charity to have been established in the UK. This is the case even if the foreign organisation satisfies all the relevant tests for charitable purposes and would have been regarded as a charity if it had been established in the UK.

In January 2009 the European Court decided that the tax relief could not be denied to charities established in the EU if they would otherwise satisfy the conditions in the UK. HMRC have been reluctant to accept this judgment, but legislation is now to be introduced to extend charitable tax relief to organisations set up for charitable purposes only and located in the EU providing they are regulated in their home country by a body with a function equivalent to the Charity Commission.

Whilst this would appear to be a relaxation, in reality it is a restriction because it will only permit relief for a narrower class of organisation than would otherwise have been allowed by the European Court of Justice (ECJ).

Penalties

Increased penalties are being introduced for people who fail to report income and gains in offshore jurisdictions. The penalties are increased to 150% of the tax where the income or gains arise in a jurisdiction which exchanges information with HMRC. The penalty will be 200% of the tax in respect of other jurisdictions.

There will also be new penalties for late filing of tax returns and the late payment of tax. A £100 penalty will apply whether or not the tax has been paid. Subsequent failures will be subject to an escalating penalty which will increase by £100 for each of the failures up to a maximum of £400 per failure. In addition, if by failing to make a return the taxpayer is deliberately withholding information to prevent HMRC from correctly assessing his liability, penalties of up to 100% of the tax will be chargeable.

It is highly relevant to the new penalties that all cheque payments sent by post will be treated as being received by HMRC on the date when the cleared funds reach their bank account – not the date when they receive the cheque. HMRC recommend that taxpayers should allow at least three working days for a cheque payment to reach them and a further three days for the payment to clear. Having regard to the stricter penalty regime, this change could be rather important.

PAYE

From April 2010 there is a more robust penalty regime for employers failing to pay their PAYE on time. This was announced last year. The Budget takes this a stage further by proposing to allow HMRC to require employers who are habitually late with their PAYE payments to provide security in the form of a financial deposit. This could be very serious indeed because, if it follows the VAT model, the employer would be criminally liable if he continues to trade without providing the security. Anybody having difficulty in paying their PAYE will obviously be unable to pay an additional amount by way of security, and the most likely outcome is that the business will have to close down.

Transactions in Securities

The anti-avoidance provisions relating to transactions in securities generally known as section 703 TA 1988 (but now sections 682-713 Income Tax Act 2007) have been around for a very long time. The idea is to cause capital receipts derived from transactions in securities to be brought into charge to tax as income. These provisions have been of limited relevance in recent years where the rates of income tax and capital gains tax were broadly similar, but now the disparity of rates between 51% and 18% is so great that all the old ideas for generating capital rather than income become extremely important.

The Transactions in Securities legislation is among the most draconian of the anti-avoidance provisions, but apparently the new (clearer) provisions will be targeted only at close companies, including overseas companies. There will be a new *bona fide* commercial test which they say will mean less uncertainty regarding its application. I can't wait.

Employee Benefit Trusts (EBTs)

EBTs have a long history as vehicles for providing benefits to employees and their families. They have been under challenge from HMRC for an equally long time, and the opportunities for using EBTs to advantage are rather limited. There is however a continued opportunity for deferral of tax and National Insurance contributions (NICs) if the employer is prepared to defer (or does not need) a tax deduction for the amounts involved. The Budget purposes further measures to bring into charge disguised remuneration through the use of EBTs, but no details are yet known.

Ordinary Residence

Yet another case has been heard by the Tribunal on Ordinary Residence: *Turberville v HMRC* TC 381. However, anybody hoping that this would provide some urgently needed clarity to the uncertainty created by the contradictory cases of *Genovese* and *Tuczka* will be disappointed.

We might not have expected too much clarification because this case was not dealing with a taxpayer coming to the UK, but concerned a taxpayer leaving the UK and seeking to become ordinarily resident somewhere else. In that case, one might have thought there would be some consistency with the case of *Gaines-Cooper v HMRC* – but sadly not.

Mr Turberville was a chartered accountant who lived in Scotland. In 1979 he joined Shell and left the UK to work in various international locations. He returned to London in February 1997 and became resident here. Throughout the period of his absence he owned houses in the UK. In July 2001 he took the senior post with TXU in Dallas. Unfortunately the fortunes of TXU declined and he was made redundant on 31 October 2002. He returned to one of his properties in the UK and made arrangements to move to Monaco. As a result of his changing circumstances he spent 118 days in the UK in 2002/03. The question was whether he was ordinarily resident for that year.

HMRC said that he had been resident and ordinarily resident until July 2001 and nothing had changed thereafter. He had always owned a home in the UK and only had temporary absences with frequent visits to his homes in the UK. Although Mr Turberville worked abroad for over one year, from July 2001 to October 2002, this did not cover a complete tax year.

Mr Turberville said that there was a complete break in his lifestyle when he became based in Dallas under a contract intending to last for the next three years and with the expectation that he would take over as chairman and remain there until his retirement.

The Tribunal decided that when he left the UK in July 2001 his three-year employment contract (and the refurbishment he undertook to the apartment rented by his employer) both pointed to a distinct break. His expectation of being appointed chairman reinforced the position. These facts demonstrated a distinct break in his lifestyle which meant that he ceased to be ordinarily resident.

Just as in *Genovese*, it was not open to the Tribunal to split the tax year and therefore he could not have ceased to be ordinarily resident until the end of the year following his departure.

However for the following tax year, the Tribunal decided that he was not ordinarily resident. He lost his job in Dallas at the end of October 2002, and it did not seem to matter that he returned to the UK to work for a while. He was arranging an apartment in Monaco, and that is where he intended to live. (Er. Um. The whole thrust of the Tribunal decision in *Tuczka* was that intention was irrelevant.) The Tribunal considered the retention of his house and flat in the UK as neutral. They did not think that the premature end to his employment and his resumption of presence in the UK caused him to become ordinarily resident again. The leasing of the property in Monaco, the acquiring of a *carte de sejour* there, involving trips between the UK and Monaco on five occasions, and then driving to Monaco in January 2003 meant that it was not possible to say he had a regular order of life anywhere; it was a time of transition. The UK was not his residence for settled purposes as part of the regular order of his life, and the physical presence was no more than a stop-gap measure. Accordingly he was not ordinarily resident in 2002/03.

It is interesting to read the Tribunal's views regarding what constitutes a distinct break because it certainly conflicts with the Court of Appeal's decision in *Gaines-Cooper* that a distinct break requires severance of all family and social ties in the UK. Mr Tuberville's mother lived here, he had two homes here, he worked here and was in the country for 118 days (and a further 22 days in connection with his mother's funeral); whatever interpretation one might give the phrase "severing all family and social ties" it surely cannot include these circumstances.

There is so much in this case which is inconsistent (and sometimes in direct conflict) with recent authorities that it just highlights the confusion over the whole subject. There is an urgent need for clarification in this area.

Time Limits

New time limits came into force on 1 April for direct taxes. The normal six-year time limit (or five years and 10 months) was replaced by a four-year time limit for both assessments and claims. HMRC will only have four years in which to raise assessments in respect of a particular tax year – except that this is extended to six years for careless behaviour and 20 years for deliberate behaviour. The 20-year time limit will still apply to cases of failure to notify and failures in respect of tax avoidance schemes.

The meaning of careless behaviour in this context is obviously crucial, and it is not clear whether this has the same meaning as negligent conduct under the existing rules or whether it is a somewhat looser test.

The position is not quite the same for VAT where careless behaviour also has a four-year time limit – and none of these time limits apply to assessments under class 1, 1A and 2 National Insurance contributions.

Tax Returns – Late Penalties

I think we should applaud Mr Powell who challenged a penalty determination made by HMRC before the Tax Tribunal: *B&J Shopfitting Services v HMRC* TC 390.

Mr Powell was late in submitting the paper tax return in respect of the partnership he carried on with his wife. He did not submit it until January 2009 whereas as a paper return, it should have been submitted by 31 October 2008. However, he knew, and so did his accountant, that there would be no penalty if he paid the tax by 31 January. This is because they looked on the Revenue website where it says, "If all the tax has been paid by 31 January the penalty notice will be issued in the sum of nil as the penalty cannot exceed the amount of tax outstanding at 31 January".

Unfortunately this did not apply to partnerships, but there was nothing on the Revenue website to suggest that this was the case.

HMRC accepted that the advice on their website was misleading, and they also accepted that the taxpayer relied on it. However, they did not think that was a reasonable excuse because ignorance of the law is no defence.

The Tribunal made it absolutely clear throughout their judgment that a taxpayer behaves reasonably if he relies on advice given by HMRC. HMRC said that ignorance of the law was no excuse, but the Tribunal considered that the taxpayer was not relying on his ignorance of the law but was relying on HMRC's misleading guidance. It must be reasonable for a taxpayer to rely on HMRC's guidance, and HMRC must ensure that they do not mislead taxpayers into mistaken acts which incur a penalty.

Whilst applauding Mr Powell for taking a stand when the amounts involved must have been very small, one does have to say that there is something deeply disturbing about HMRC publishing guidance which is admittedly misleading and then imposing penalties on people who rely on it. Who could possibly have thought this was the right thing to do? Surely HMRC should not need the Tribunal to tell them that this is wrong.

Dividends

Some uncertainty has arisen recently about the corporation tax treatment of distributions. This has arisen from arguments by HMRC in the Tax Tribunal that the meaning of a dividend for tax purposes was different from its company law meaning and that dividends are of an income or capital nature depending upon the reserves out of which they are paid. What HMRC had in mind is that if they could categorise dividends as capital, they could be brought into charge to corporation tax and not be exempt which is the case with dividends generally.

A ministerial statement has been issued to confirm that dividends will not be excluded from the exemption because they are capital distributions and it will have retrospective effect. The Budget notes also made reference to this issue by saying that only distributions which are specifically excluded from clarification as income will be treated as capital and chargeable to tax as a capital gain.

Main Residences

Not wishing to be accused of taking a cheap shot, I cannot help smiling about the stories relating to members of both Houses of Parliament who claim that a property is a “main residence” even if they visit it only once a month. I thought this was because of some obscure definition included in the expenses rules; apparently not. It is understood that the Clerk of the Parliaments made it clear that a main residence was one which was visited with a degree of frequency in the order of at least once a month over the year when the House is sitting.

HMRC use a rather more rigorous test in connection with the capital gains tax exemption for the only or main residence. As a residence is not specifically defined for the purposes of capital gains tax, anybody with a second home might like to use this test in claiming the capital gains tax exemption.

Agricultural Property

The Tax Tribunal has delivered a judgment in the case of *Atkinson v HMRC* TC 420 relating to the meaning of agricultural property for the purposes of inheritance tax. One of the partners in a farming partnership lived in a bungalow on the farm until ill health required him to move into a care home. His possessions remained there and he made occasional visits to the bungalow.

HMRC said that the relevant condition – for the property to have been occupied for the purposes of agriculture for the period of seven years ending with his death – had not been satisfied. They argued that Mr Atkinson could not realistically be said to be in occupation nor could it realistically be said that the property was being used for the purposes of agriculture. That seems like quite a compelling view.

However, the Tribunal said that Mr Atkinson was a partner in the farming partnership until he died. The bungalow was used to accommodate the diminishing needs of one of the partners. Accordingly, they concluded that the bungalow was agricultural property and that the relief was available.

Champions League Final 2011

It is a truth universally acknowledged that a single man in possession of a good fortune must be in want of…a tax exemption. Unfortunately there is also a universally acknowledged truth that if you have a fortune you are not welcome in the UK – unless it seems if you are a foreign footballer and are playing in the Champions League Final next year. The Finance Bill 2010 provides an exemption for income tax in respect of employment income, self-employed income and endorsement income of foreign players and officials relating to this match. More of this next month. It will be a laugh (and a complete waste of time) if two English teams are in the final next year. This is not an April Fool – I promise.

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Articles and Publications – March 2010

Peter Vaines: Institute of Taxation Conference: 29 March 2010

Peter Vaines: Articles: *New Law Journal*
Business Week Europe
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