SQUIRE SANDERS | LEGAL COUNSEL WORLDWIDE

UNITED KINGDOM TAX BULLETIN

Squire, Sanders & Dempsey

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CURRENT RATES — June 2010

Indexation

Retail price index: May 2010	233.6
Inflation rate: May 2010	5.1%

Indexation factor from March 1982:

to April 1998	1.047
to May 2010	1.815

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%

The Budget – Developments

There is not much more to say about the Budget – except that there is some helpful clarification about capital gains tax. It was interesting to note that the day before our Budget was released, Russia decided to scrap capital gains tax as a measure intended to increase economic activity. Huh. Don't they know that you increase economic activity by big increases in taxation?

Further details have been provided regarding the transitional provisions for capital gains tax – that is to say, gains arising before and after Budget Day. There was considerable uncertainty on Budget Day about the meaning of gains "arising" because those arising before 23 June are taxable at 18% and those arising afterwards are subject to the 28% rate.

Where a person has been temporarily non-resident under Section 10A TCGA 1992 and resumes UK residence within five years, the gains chargeable in the year of his return will be treated as arising before Budget Day and therefore taxable at only 18%.

A similar uncertainty arose relating to individuals who are taxed on the remittance basis and where a gain was made on a disposal before Budget Day but was not remitted until after Budget Day. The new rule is that the date of remittance will determine whether the gains are treated as arising before or after 23 June. Just to make life complicated, where Section 809J applies to a remittance from a mixed fund where the statutory order of remittance applies, all such gains arising from those remittances will be treated as gains arising before 23 June and subject to the 18% rate.

Where Section 86 TCGA 1992 applies (where a UK-domiciled settlor is taxable on the gains made by a non-resident trust) all the gains chargeable on the settlor for 2010/11 will be treated as arising before 23 June and taxable at 18% only. In cases where Section 87 applies and the charge to capital gains tax on beneficiaries is based on the receipt of capital payments, it will be the date of the capital payments which determines whether the 18% or 28% rate applies.

A helpful relaxation is proposed in respect of Entrepreneur Relief where shares are disposed of in exchange for qualifying corporate bonds (QCBs) after Budget Day. An election can be made for the gain not to be deferred but brought into charge at that time and the relief claimed. This is likely to be advantageous because without the election, it would be unusual for any gain arising on the ultimate disposal of the QCBs to qualify for Entrepreneur Relief.

The Budget confirmed earlier announcements that certain distributions received by UK-resident companies will be exempt from corporation tax with effect from 1 July 2009 – but with companies having the ability to opt out if it is to their advantage. The draft legislation and explanatory notes have now been published.

There will be two more Finance Bills this year – one published on 1 July and one in the autumn. The first one deals with the capital gains tax, value-added tax pensions and insurance premium tax issues – and the obviously high-priority provisions relating to the exemption from tax of MPs expenses and allowances. Everything else will be deferred until the autumn.

Residence

Another case relating to residence has been decided by the Tax Tribunal: *Farquhar v HMRC* TC 532. It concerned a man who left the UK to take up full-time employment abroad, and having regard to the recent Court of Appeal judgment in *Davies and James v HMRC*, this should have been very interesting. However, the Tribunal dismissed his appeal holding that he remained UK-resident for all the relevant years, but unfortunately they did not give any reasons for that decision. Strange but true.

Mr Farquhar argued that he had satisfied the tests in IR20 – i.e., the requirement in paragraph 2.2 that he had left the UK to work full-time abroad under a contract of employment and had not visited the UK for more than 90 days on average during his period of absence. Very interesting – but it has absolutely nothing to do with the Tax Tribunal who are unable to consider IR20 because it is not the law. It is merely HMRC practice. If HMRC do not adhere to their published practice, you can apply for Judicial Review in the High Court. The Tribunal suggested that Mr Farquhar did so and expressed their own view that they thought the taxpayer had a legitimate expectation on which such a claim to Judicial Review could be founded. The Tribunal also suggested that the taxpayer referred his case to the Revenue Adjudicator. Curiouser and curiouser.

Where did all this leave Mr Farquhar? Inexplicably, despite the fact that in all the recent cases relating to residence the Tribunal and the Special Commissioners have made it very clear that they will look at the law and cannot consider the terms of IR20, both the taxpayer and HMRC just argued about IR20. Furthermore, in their findings, the Tribunal dealt only with the application or otherwise of IR20 and did not deal with any aspect of the substantive law at all – and then decided that Mr Farquhar was UK-resident for the years in question.

It would have been helpful to have had some reference to the legal position (anything would be nice) about how they came to that conclusion. I am afraid not, so neither we nor Mr Farquhar, I expect, have any idea why he lost his case.

Coming to the UK

It is interesting to note that HMRC have announced that from 1 June there is no requirement to send in a form P86 when arriving in the UK.

This sounds like an administrative simplification but form P86 did provide valuable information to enable HMRC to ensure that people coming to the UK were brought into the tax net at an early date. It has been suggested that HMRC are probably able to obtain the same information from other sources and do not need form P86 anymore, but I cannot really imagine that this is the case.

Error or Mistake Claims

Since 1 April 2010 it has no longer been possible to make an error or mistake claim. This has been replaced by what is known as "overpayment relief" which is remarkably similar. Claims for overpayment relief must be made within four years of the end of the tax year or the accounting period to which the claim relates – although there are some transitional provisions for mistakes in 2004/05 and 2005/06.

Overpayment claims must be made in writing and cannot be made in self-assessment returns – indeed they will not be accepted if they are included in a return.

Both the old and the new relief have an exception in respect of prevailing practice. That means that no relief can be given if the basis upon which the tax was computed was in accordance with the prevailing practice at the time. Disputes can (and have) arisen about what represents prevailing practice, and they will no doubt continue. However, as a result of the decision of the Court of Appeal in the FII Group Litigation, claims for error or mistake relief or overpayment relief relating to tax paid in breach of EU law will not be disallowed on these grounds.

Sponsorship Payments

The Tax Tribunal have recently heard a case on the allowability of sponsorship payments made by a trading company to Plymouth Albion Rugby Football Club: *Interfish Ltd v HMRC* TC 520. The question was (of course) whether the payments were deductible in computing the company's profits for corporation tax. The general facts were broadly familiar. Interfish Limited was a substantial company in the fish industry in the South West. The controlling director, Mr Colam, was interested in rugby and took the view that by sponsoring the rugby club he would obtain influence for Interfish in the business community for which the club acted as a focal point. Lots of evidence was given about the advantages which derived from that sponsorship, and Mr Colam was emphatic that the payments were made with the view to achieving those benefits. The Tribunal found as a fact that the payments would not have been made if the anticipated benefits would not have accrued to the company. Mr Colam was not using the company to finance the club simply in order to give himself the satisfaction for status of being a benefactor. OK so far.

The test here was the traditional test in Section 74 TA 1988 of whether the expenditure was incurred wholly and exclusively for the purposes of the trade.

The Tribunal examined the celebrated case of *Mallalieu v Drummond* where it was decided that the expenditure on professional clothing also had a private (albeit subconscious) purpose, as well as the case of *Bowden v Russell & Russell* where the taxpayer incurred travel expenditure to promote his profession and to take a holiday. Both cases failed on the grounds of duality of purpose. The Tribunal judge found that the sponsorship payments by Interfish were not deductible for the same reason.

I do wonder, however, whether this is the right test. These cases related to unincorporated businesses where it was found that personal benefit played some part in the motivation for the payments. However, the company can have no personal benefit – the only persons capable of having a personal benefit in this context are the directors or employees. If therefore the motivation for the sponsorship payments was partly to benefit the company's business and partly to advance some purpose of the directors or employees, it would still be fully allowable. The provision of benefits to directors is clearly expenditure laid out wholly and exclusively for the company's trade – possibly giving rise to a benefit in kind charge, but that is hardly relevant here.

It may be that (as in Executive Network SpC 56) the identity of the recipient of the sponsorship and the directors' keen interest in the club have confused the analysis of the tax treatment. That could be relevant to the tax position of the directors but not to the tax deductibility of the payments by the company.

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