SQUIRE SANDERS HAMMONDS | LEGAL COUNSEL WORLDWIDE

UNITED KINGDOM TAX BULLETIN

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March 2011

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CURRENT RATES	March 2011
Indexation	
Retail price index: February 2011	231.3
Inflation rate: February 2011	5.5%
Indexation factor from March 1982:	
to April 1998	1.047
to January 2011	1.883
to February 2011	(not yet announced)

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: From 6 April 2010 4%

Ramsay Doctrine

The Ramsay Doctrine seems to be having some kind of renaissance. I think it was generally considered that the House of Lords decisions in 2006 in *Barclays Mercantile Business Finance Limited v Mawson* and *CIR v. Scottish Provident Institution* were just about the last word on the Ramsay Doctrine. However, we would appear to be moving back to the original thinking.

Last year in the case of *Schofield v HMRC* TC 439, the First Tier Tribunal held that a capital gains tax avoidance scheme involving gilt options was a fiscal nullity on original Ramsay principles. We now have the case of *Berry v HMRC,* which also involved a capital gains tax avoidance scheme, this time involving gilt strips, and this was also done down by the High Court. It has some interesting (and not so interesting) features.

I am no defender of complex tax schemes, but I am quite a fan of the Rule of Law. I have a feeling that this gets a bit lost when tax is in issue – and more particularly when poetry appears as part of the reasoning process in legal judgments.

For those who think I have completely lost it, I would refer to the case of *Re McDermott's Application 1996* STC 483 where a stamp duty issue was decided by the Judge who concluded his judgment by saying that "the answer to [Counsel for the taxpayers] point was supplied long ago by old Khayyam" whereupon he quoted the 71st quatrain of the "Rubaiyat of Omar Khayyam". I always thought this was a curious approach. However, the idea seems to have been picked up by the judge in the case of *Berry v HMRC* FTC/29/2010 where his Lordship concludes his judgment with an extract from "Little Gidding" by T.S. Eliot. I think the expression is Go Figure.

Mr Berry's claim for loss relief failed on Ramsay principles on the basis that the reality of the situation was that there was no genuine loss. There were certain difficulties with this approach because to reach this "reality", certain real things had to be ignored. In this case there was a real risk that a loss may arise, but it was disregarded as "an anti-Ramsay device". It is a bit worrying if anything which gets in the way of a Ramsay argument can simply be disregarded as an anti-Ramsay device. As Ramsay is a rule of statutory construction, this is going to apply to the innocent as well as the guilty – collateral damage, I suppose. Blackstone's celebrated principle that it is better that 10 guilty men go free than one innocent man be convicted seems to have been turned on its head when it comes to the present approach to tax schemes.

The Budget last week contained quite a lot about tax schemes. Measures (to be known as "statutory consequences") are to be introduced to discourage the use of tax schemes. This would seem to include an additional surcharge where a spotlighted tax scheme is used (and fails) or possibly a requirement for the tax in dispute to be paid up front, the idea being to eliminate any cash flow advantage being obtained by those using such schemes.

Ordinary Residence

The Upper Tribunal has now heard the appeal in the case of *Tuczka v HMRC* on ordinary residence. It may be remembered that Dr Tuczka came to work in the UK expecting to be here for less than three years. He had no intention of staying in the UK; his purpose in coming here was to obtain some international experience and return to Austria. HMRC claimed that he should be ordinarily resident shortly after his arrival. Dr Tuczka said that he should not have become ordinarily resident until he had been here for approximately three years, or until he was here for a settled purpose. He was neither. His accommodation in London was very basic; he maintained a home in Austria where his family lived; his duties took him all over the world and he made frequent trips home. He was gaining the relevant experience here but was interviewing back in Austria with the clear intention of returning there within three years.

The Tribunal took the view that Dr Tuczka had come here voluntarily for employment which was a settled purpose; there was no minimum period which needed to be satisfied. Accordingly he could be ordinarily resident soon after his arrival. How soon – well, not quite sure. How about the beginning of the next tax year? HMRC argued vigorously in favour of this proposition – completely contrary to their long established practice in IR20, but this seems to be the way these days. The Upper Tribunal said very little. There was a great deal of introductory material, and they concluded that the First Tier Tribunal had applied the correct tests. To be ordinarily resident, it is necessary for him to be in the UK voluntarily and for a settled purpose; therefore the appeal was dismissed.

It is a pity that the Court did not take the opportunity to clarify some confusing elements of the decision of the First Tier Tribunal or to address the inevitable consequence that there is now no significant distinction between residence and ordinary residence – at least not one which can be safely articulated. Anybody coming to the UK for work is very likely to find himself ordinarily resident almost immediately and therefore liable to the high rates of UK income tax on the whole of their worldwide income. They might (only might) escape this treatment for the remainder of the tax year in which they arrive, but almost certainly not thereafter.

There are many people who have come to work temporarily in the UK on the basis of the previous understanding of the law and practice – *i.e.,* that they would be resident but not ordinarily resident for the first three years. They will now find themselves in serious difficulty. Furthermore, senior executives of major corporations will almost certainly ensure that they and their businesses stay away. They used to rely on the established HMRC practice, but now that they know that HMRC will argue the opposite in court, there can be no confidence about how they will be treated for tax purposes.

Company Residence

The case of *Laerstate BV* was concerned with the question of corporate residence. It may be remembered from earlier *Bulletins* that this case chronicled the power struggle between Tiny Rowland and Dieter Bock over the control of Lonrho. Although Mr Bock was unsuccessful in arguing that the company was non-resident, the case was noteworthy as it set out the various tests to be applied in determining corporate residence – and there was no dispute between HMRC and the taxpayer regarding the relevant tests to be applied.

Having regard to the importance of the subject matter, and the fact that the taxpayer's appeal to the Upper Tribunal has been struck out, it may be helpful to repeat the substance of the Tribunal's comments:

- There remains the classic formulation that a company resides where its real business is carried on – where the central management and control actually abides.

- There is no assumption that central management and control must be found where the directors meet. Where a company is managed by its directors in board meetings, that may be the location of central management and control. But if the management is carried out outside board meetings, it is necessary to identify who is managing the company and making the high-level decisions – and where they were doing it. (This remains the case, even though it may be contrary to the company's constitution.)

- The whole picture must be considered to arrive at the factual conclusion of where central management and control abides. The location of the signing of documents and the making of board resolutions is significant, but a company's residence will not fluctuate merely because individual acts of management take place in different places.

- The mere act of signing documents is not conclusive – the local directors must apply their minds to whether or not to sign the documents. There is nothing to prevent a majority shareholder from indicating how the directors of the company should act. If the directors consider those wishes and act on them, it is still their decision. The distinction is between directors making a decision and not a making decision at all – for example, just signing documents without any real consideration. The decisions of the directors must be informed decisions – merely going through the motions is not enough. The directors might follow the wishes of the shareholders, but they must have the minimum information necessary to make a decision. Without that minimum information, there will be no decision at all.

- It would be exceptional for a parent company to assume the functional management of its subsidiary; a parent usually operates through the boards of its subsidiaries. However, this would not be the case if the parent company usurps the functions of the local boards.

These comments usefully supplement other key decisions such as *Untelrab* and *Wood v. Holden,* which now seem to represent a reasonably comprehensive code on this subject.

The Budget

There was not really very much in the Budget beyond the points which were summarised in our overnight *Budget Bulletin*. However, the following might also be of interest:

- There were some changes announced to Stamp Duty Land Tax (SDLT), some inevitable anti-avoidance provisions, but also a relaxation in the application of SDLT to the purchase of multiple residential properties from the same vendor. There were some dark murmurings about owners of high-value properties not paying their full share, but nobody is clear what this means. It could mean a new SDLT charge on property-owning companies perhaps or possibly a resurrection of the mansion tax (surely not.) We shall see.

- The new 5% rate of SDLT to residential property over £1 million applies to transactions after 5 April 2011. Where a contract was entered into before 25 March 2010 (yes, last year) but is not completed until after 2011 (and not varied or assigned in the meantime), the old rate of 4% will still apply.

- The press picked up an idea that the averaging relief for authors and for farmers was being abolished – but this was an assumption too far. These reliefs are not being abolished.

- Donations to charity are being encouraged by a more generous approach to Gift Aid and an imaginative relief for Inheritance Tax whereby if a deceased gives more than 10% of the estate to charity, the tax rate on the remainder of the estate is reduced to 36%.

- HMRC have published some Questions and Answers on the revisions to the Enterprise Investment Scheme and Venture Capital Trusts. Nothing new, except confirmation that if you carry back EIS relief to 2010/11, you only get relief at the old rates.

- The Research and Development enhanced allowances for SMEs are to be significantly increased from 175% to 200% of qualifying expenditure after 1 April 2011 and increased again to 225% in the following year. Furthermore, the cap on the relief for SMEs to the amount of PAYE/NIC paid is abolished, along with the £10,000 minimum spend limit.

- The profit limit for CFCs is increased from £50,000 to £200,000, and there is to be a relaxation for overseas group finance companies which could have the effect of reducing the corporation tax rate to 5.75% by 2014 depending on the debt equity ratio.

- The proposed new rules for foreign branches are also attractive. There is to be an opportunity to elect for a tax exemption in respect of trading profits arising from foreign branches. This is not to apply to small companies (less than 50 employees and either turnover or assets below €10 million) unless they are resident in a treaty country. Losses will not be relievable – nor will a company be able to elect for this exemption until any losses sustained in the previous six years have been matched by profits. However, as the exemption is not compulsory but only by election, it will still be possible to obtain relief for losses in foreign branches.

- The Finance Bill was published today which includes 60 pages (!) of draft legislation on Disguised Remuneration. It will take a little time to identify whether there has been any change in the proposals beyond those highlighted by the FAQs last month. Stay tuned.

Penalties

HMRC have introduced new penalties effective from April 2011. If you did not file your tax return on time last year, there was a penalty of £100 – but that did not apply if there was no tax payable. HMRC say that it was not much of a deterrent. The new penalties will apply whether there is any tax outstanding or not.

There will be a £100 penalty for a late return; after three months there will be an automatic penalty of £10 per day (up to a maximum of £900); after six months there will be a further penalty which is the greater of 5% of the tax due or £300; after 12 months there will be another 5% or £300. A penalty of £1,300 for filing your tax return six months late and where there is no tax outstanding looks a bit steep. (I wonder what the position is if HMRC send you a tax return but there are no entries to put on it. Perhaps you should send it back with zero in every box together with a cheque for £0.00 just to be on the safe side.)

The penalties for failing to pay your tax on time are also increased. There is interest of course (which they say is just commercial restitution for being out of the money – funny that the same rate does not apply to tax repayments), but there will be a penalty of 5% of the tax unpaid if it is 30 days late, a further 5% if it is six months late and further 5% if it is 12 months late.

HMRC have also confirmed that the penalties for failing to disclose offshore income also come into force on 6 April 2011, with the penalties being cranked up depending on where the money has been deposited. For those territories which are looked on with disapproval by HMRC (like the UAE and Brazil, for example), the penalties can be 200% of the tax involved. At a tax rate of 50% this represents total confiscation.

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