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UNITED KINGDOM TAX BULLETIN

Squire, Sanders Hammonds

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CURRENT RATES — August 2011

Indexation

Retail price index: July 2011	234.7
Inflation rate: July 2011	5%

Indexation factor from March 1982:

to April 1998	1.047
to June 2011	1.961
to July 2011	(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: From 6 April 2010 4%

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£30,000 non-dom charge

When the non-dom charge was introduced in 2008, the Budget papers contained a lengthy opinion obtained by HMRC from Skadden, Arps, Slate, Meagher and Flom LLP, the distinguished US firm, to the effect that credit would be available for the £30,000 charge against the individual's liability to US tax.

(It seemed to me that for HMRC to structure the non-dom charge in this way was quite brilliant – certainly as far as US citizens were concerned. They would be generally chargeable to US tax on the whole of their worldwide income and if they paid an extra £30,000 in the UK but received credit for it against their US tax, it would not touch them at all.

What was even more brilliant was that we would be imposing a tax here which would be effectively paid by the US Treasury. It is perhaps for this reason that the US Internal Revenue Service have taken rather a long time to consider whether the £30,000 charge is eligible for credit in the US.)

However, the IRS has now issued a Revenue Ruling 2011-19 confirming that the non-dom charge is creditable for US income tax purposes. The Revenue Ruling is lengthy, but concludes that the non-dom charge will be eligible for a credit.

However, their conclusion does contain a caveat as follows:

"A credit for the [non-dom charge] will be available only if the other legal requirements for obtaining a foreign tax credit are satisfied. For example, an amount paid is treated as a compulsory payment of income tax only to the extent that the taxpayer applies the substantive and procedural provisions of foreign law, including elective provisions such as those available under UK law relating to the [non-dom charge] in such a way as to reduce, over time, the taxpayers reasonably expected liability under foreign law for income tax."

Not being a US tax advisor, or well versed in the obscure phrases used by the IRS (which are significantly different from the obscure phrases used by HMRC), I hesitate to comment, but there does seem to be an issue here. I guess what they are trying to avoid is the position where the US citizen simply pays the non-dom charge without giving consideration to any of the figures because he will get credit for it in the US anyway. Such a person may not obtain any benefit from the non-dom charge because for example, the tax saving from claiming the remittance basis may only have been £25,000 - or they may have been able to reduce their UK liability by reliefs or allowances which they have not bothered to claim. In these circumstances I can see that the IRS might refuse credit for the £30,000 charge because if it had not been paid, the UK tax liability would have been smaller. It will be interesting to see how this issue plays out in the coming months.

Double Taxation Relief

The anonymised tribunal case of Swift last year has now been appealed to the Upper Tribunal and is now known as Anson v HMRC FTC39/2010. Coincidentally this also related to relief for US tax (groan!) but stick with it because is contains an interesting feature.

The case concerned a claim for double taxation relief by Mr Anson in respect of tax paid by a Delaware LLC. Mr Anson had been taxed in the US on the profits of the LLC on the basis that the LLC was transparent. Mr Anson received those profits from the LLC on which he was taxable in the UK. He claimed double taxation relief on the basis that the US tax "*shall be allowed as a credit against any UK tax computed by reference to the same profits or income by reference to which the US tax is computed*" under the UK/US treaty.

Unfortunately however HMRC did not agree. They regarded the LLC as opaque and therefore there was no entitlement to double taxation relief. The prospect of being taxed in both countries with no relief is the stuff of nightmares – particularly having regard to current rates of tax.

The first tier tribunal found that Mr Anson was entitled to credit on the grounds that he had an interest in the profits of the LLC – but the Upper Tribunal has decided that was wrong. He did not have any interest in the profits under English Law – it was just that the US tax code imposed a transparency for US tax purposes. Therefore the profits on which the tax had been paid in the US were the profits of the LLC and Mr Anson was taxed on something else – his distribution from the LLC. These were different sources of income and the test for relief under the treaty was not satisfied.

However, this may not be the end of the matter. Mr Anson has another argument – that if the transfer of assets abroad provisions in Section 739 TA 1988 (now Section 720 ITA 2007) apply, then the income of the LLC would be treated for all the purposes of the Income Tax Acts as his income. Sounds good.

Unfortunately, the first tier tribunal decided that Section 739 did not apply because of the bona fide commercial exemption in Section 741 – in other words there was no tax avoidance purpose.

The point is now to be reconsidered by the Upper Tribunal (at a fresh hearing) and this could be very interesting. Section 741 would appear to be available only to the taxpayer and not something able to be claimed by HMRC. It says that Section 739 "*shall not apply if the individual shows in writing or otherwise to the satisfaction of the Board*" that no tax avoidance purpose was involved. It is clear that Mr Anson did no such thing. It could be said that the exemption in Section 741 (and its latest incarnation in Sections 736-742 Income Tax Act 2007) provides a compulsory exclusion from the transfer of assets abroad provisions if the facts fit. However such a conclusion is difficult to reach in the light of the condition that the individual has to satisfy the Board in writing that the conditions apply. We shall see.

Discovery Assessments

There is some really good news about discovery assessments. For years these have represented a serious problem. The point is so important that I make no apology in repeating some of the comments made in the October 2010 bulletin.

HMRC are only entitled to raise an assessment outside the enquiry window if they discover that an assessment to tax is insufficient. There is a balance here between the taxpayers' entitlement to finality which is the cornerstone of self assessment, and the right of HMRC to correct a possible under assessment of tax. This balance was explained by Park J in the case of Langham v Veltema as follows:

"[Self Assessment] imposed new burdens on taxpayers by requiring them to submit fuller tax returns than had previously been required …. The new burdens were balanced by new protections for taxpayers who conscientiously comply with the system, in particular by new and tighter time limits on the power of the Revenue to make further tax assessments".

That new protection proved to be illusory. The decisions in such cases as Langham v Veltema and Hankinson v HMRC, demonstrated that there is little to prevent HMRC raising an assessment on the basis of a discovery. The test is that the inspector could not reasonably have been expected, on the basis of the information supplied to him by that time, to be aware of the insufficiency in the assessment. The information supplied to him must clearly alert the inspector to the insufficiency of the assessment.

This gives rise to the impossible conundrum that if you believe (on good grounds) that your tax return is correct you therefore do not consider there is any insufficiency, so you cannot then "clearly alert the officer to the insufficiency". By failing to do so, the door is open to HMRC to raise the assessment on the grounds of discovery. However, if you know that your tax return is incorrect HMRC would be able to raise an assessment on the grounds that you have knowingly submitted an incorrect return.

This Catch 22 position never cut much ice with the Courts but the case of Lansdowne Partners did indicate that the taxpayer will be protected if he had given adequate information to HMRC to enable them to decide whether or not an additional assessment should be raised within the time limit. The taxpayer is entitled to say that if HMRC wanted to disagree with his self assessment, or to challenge a claim or deduction, they had all the information necessary to do so before the expiry of the enquiry window.

It is with this background that the recent decision in Charlton v HMRC TC1317 is obviously very helpful. In this case, the taxpayer made a claim for a capital loss. Full disclosure had been made by the taxpayer but HMRC had not opened an enquiry into the matter before the end of the enquiry window. Nevertheless, they sought to raise a discovery assessment later.

The tribunal dwelt extensively on the meaning of "discovery" in Section 29 (1) Taxes Management Act 1970, deciding that the old authorities on the meaning of discovery remained good – that a discovery can occur merely by the original inspector changing his mind, or a new inspector taking a different view, without any new facts having been discovered.

However, it is also necessary to consider the requirement in Section 29 (5) which is whether the inspector could reasonably have been expected to be aware, on the information provided, that there may be an insufficiency. It was this question which was fundamental to the appeal – and to the protection of taxpayers generally. Mr Charlton said that everything was perfectly clear from the full disclosures in the tax return.

HMRC argued that the statute required the taxpayer to have made it clear to the inspector that there was an actual insufficiency in the self assessment made in the returns, not that there simply might be an insufficiency. (This is manifestly absurd – it represents the Catch 22 argument that the taxpayer is only protected if he tells HMRC that his tax return is wrong when he sends it in.)

Of course facts will vary but in this case the tribunal decided that no HMRC officer could have examined the tax return without it being instantly obvious that there may be an insufficiency. This reinforces the point made in Lansdowne that if HMRC wanted to disagree with the self assessment or to challenge the loss claim, they had all the necessary information and should have so before the enquiry window closed.

An interesting additional feature in the case of Charlton concerned whether the inspector can or should make further enquiries. It has been clearly established in earlier cases that it is not enough for the taxpayer to say "*you could have enquired*"; that places too great a burden on HMRC. The inspector needs to be able to make the relevant judgment on the basis of information before him without any need to make further enquiries. However, in Charlton it was suggested that this concept needs to be refined.

"We consider that the ban on raising further enquiries about the facts, implicit in the Court of Appeals decision in Veltema, and indeed in Subsection 29 (6), has no bearing on how we should expect the notional officer to approach his proper task of then considering information and deciding whether or not he should raise assessments. And if it is glaringly obvious either that the relevant officer should consider the law, and possibly refer to published material or, where an SRN number is disclosed, simply send an email or make a phone call to colleagues and ask for guidance, this is precisely how we would treat the notional officer as proceeding".

This is a clear departure from the HMRC view set out in Statement of Practice SP1/06. Furthermore the tribunal did not support the HMRC view (again in SP1/06) that the taxpayer must specifically draw attention to any divergence from the published HMRC view on a matter, to be protected from a discovery assessment.

Whilst this case brings a welcome balance to the self assessment process, it may be too much for HMRC to accept and I guess an appeal is likely.

Switzerland

The UK and Switzerland have entered in to an agreement which will come into force in 2013 whereby the whole of any funds held by UK taxpayers in Swiss acccounts will be subject to a charge of between 19% and 34% depending on how long the account has been open. This charge will cover all past tax liabilities to include income tax, CGT, IHT and VAT. It will apply to accounts which were in existence on 31 December 2010 and are still open on 31 May 2013.

From 2013 there will also be a withholding tax of 48% on income and 27% on capital gains together with information sharing provisions.

These charges will not apply if the taxpayer authorises full disclosure to HMRC because then HMRC will be able to pursue any unpaid tax liabilities in the normal way.

It is not clear what happens if funds are moved out of Switzerland before 31 May 2013, for example to Liechtenstein to take advantage of the Liechtenstein Disclosure Facility - although the liability under the LDF which includes interest and a 10% penalty could well be more than the charge under this new initiative.

The position of non- doms is unclear. There is some suggestion that UK non-doms will be able to escape these charges by providing appropriate assurance about their domicile status but no official confirmation in the UK or Switzerland has been published on this point.

Reasonable Excuse

Having regard to the hard line being taken by HMRC on any kind of error, it is comforting to know that tax tribunals are bringing some sense to bear when it comes to reasonable excuses.

A problem arises when the taxpayer relies on somebody else (e.g. his accountant) who lets him down with the result that a penalty becomes chargeable. Is this a reasonable excuse? Of course it depends.

In Rowland v HMRC (2006) the Special Commissioners decided that reliance on a third party can be a reasonable excuse (although not unfortunately for VAT purposes where it is specifically precluded by s71 VAT Act 1984); however whether it is actually a reasonable excuse will depend on the facts.

This reasoning has been reaffirmed in the recent case of Rich v HMRC TC 1380 where the taxpayer had provided his accountants with all the relevant papers and documents in ample time for all deadlines to be met for tax purposes and had given the appropriate instructions. The accountants failed to do so, the tax was paid late and surcharges arose.

HMRC took the view that Mr Rich did not take all the steps that could be taken by a prudent person exercising reasonable foresight and due diligence. (It is not clear where they get this definition of a reasonable excuse because it differs from the test set out in B & J Shopfitting in 2010, confirmed in subsequent decisions, which is to act in a way that someone who seriously intends to honour their tax obligation would act.)

Anyway the Tribunal did not agree with them, deciding that it was reasonable for Mr Rich to have relied on his accountants to notify HMRC in good time, and there was no reason for him to think that they would fail to do so. Accordingly, Mr Rich had a reasonable excuse and the surcharges imposed by HMRC were set aside.

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