SQUIRE SANDERS HAMMONDS | LEGAL COUNSEL WORLDWIDE

UNITED KINGDOM TAX BULLETIN

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December 2011

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CURRENT RATES	**December 2011**
Indexation	
Retail price index: November	238.5
Inflation rate: November 2011	5.2%
Indexation factor from March 1982:	
to April 1998	1.047
to November 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%

Autumn Statement

A week after the Chancellor's Autumn Statement, HMRC issued hundreds of pages of press releases dealing with a wide variety of issues. Not much was particularly earth shattering – it mainly contained matters which were announced last March and will appear in the Budget next March – but there were a few things which might be of interest:

Statutory Residence Test : This was announced last July and there have been numerous consultations (which have been generally supportive) but there are clearly too many problem areas for it to be settled by April 2012. Accordingly, the statutory residence test is being deferred until April 2013 rather than April 2012. Whilst it is obviously helpful to make sure that the new statutory test is as good as it can be (by eliminating the numerous areas of uncertainty which have been highlighted) it does leave taxpayers in a continuing state of uncertainty over their present position for another year because the existing rules will continue until 6 April 2013.

Seed EIS : The Enterprise Investment Scheme is being extended in respect of shares issued after 6 April 2012 to create a new relief applicable to smaller companies – those with 25 or fewer employees and assets up to £200,000. Income tax relief worth 50% of the amount invested up to £100,000 per investor. This is just an extension of the existing EIS scheme on rather more generous terms for smaller companies. So capital gains tax exemption will be available on capital gains on shares within this scheme as well as the general EIS. But there is more. There is also a special offer (one year only) whereby capital gains received in 2012/13 which are invested in a Seed EIS company will be completely exempt. The possibility of 78% tax relief for an investment looks pretty attractive and if that does not encourage lots of activity, nothing will.

Gifts to Charity : The detailed rules regarding the proposal to reduce the rate of inheritance tax where more than 10% of an estate is left to charity have now been published. The general idea is that IHT will be reduced from 40% to 36% for estates where at least 10% of the assets are left to charity. There are complications here because an estate may also comprise settled property and gifts with a reservation. Obviously the position would be distorted if one had to count such additional items within the total, so the 10% is calculated on each component of the estate and relief given by reference to that component. The relief is intended to assist the charity and not the taxpayer – but the charity's benefit can be really significant. For example if £100,000 of the free estate is fully chargeable and 10% of it is given away, the charity will receive £10,000 but the cost to the estate will be only £2,400 by reason of the reduction to 36% on the net estate of £90,000. Giving away 10% of the estate sounds like a lot but if you can do so in a way which only costs £2,400, it looks irresistible.

SDLT : Despite widespread speculation, there was no mention in the Autumn Statement of any proposal to introduce SDLT on the transfer of shares in property owning companies. However this continues to be a political hot potato and you never know what might happen in March.

Non Doms : The detailed rules have now been published regarding the changes previously announced. There is an increase in the non dom charge to £50,000 for those who have been in the UK for more than 12 years; new rules for encouraging business investment by allowing overseas income or gains to be remitted tax free for the purposes of a qualifying investment; a simplification of the treatment of nominated income; relaxation to the rules for assets remitted to and sold in the UK and for foreign currency bank accounts.

Patent Box : Consultations are continuing regarding the patent box regime to allow companies to elect to apply a 10% rate of corporation tax on profits attributable to qualifying patents and other IP rights. This will not be coming in before 2013.

Controlled Foreign Companies : Consultations are continuing here too, to determine how and when the profits of a CFC will be chargeable to tax in the UK. I will return to this subject when the present fog has cleared.

Presumption of Continuity

In the September Bulletin I mentioned the case of *Syed v HMRC TC 1776* which looked like a straightforward case of HMRC denying a tax deduction for some expenses in a sole traders accounts. Er, no. Having agreed an adjustment to the computations, HMRC then decided to raise assessments for the previous 4 years on the grounds that they were justified by the presumption of continuity – a phrase which derives from the case of *Jonas v Bamford 51 TC1* in which the High Court said:

"*Once the Inspector comes to the conclusion that on the facts which he had discovered, Mr Jonas has additional income beyond that which he has so far declared to the Inspector, then the usual presumption of continuity will apply. The situation will be presumed to go on until there is some change in the situation, the onus of proof of which is clearly on the taxpayer.*"

Despite the fact that there was no suggestion of anything wrong in the previous years, the Tribunal agreed that HMRC were entitled to assess the earlier years without any further justification.

I suggested that this seemed to be inherently unjust and unreasonable, (quite apart from it being contrary to the decision in *Jonas v Bamford* which did not encompass earlier years) and that anybody who agreed a disallowance or an adjustment in their tax computations was going to be at serious risk as a result of this decision. The fact that the arguments of HMRC were also contrary to their manuals on the subject did not protect the taxpayer.

It is therefore comforting to read the decision in *William Chapman v HMRC TC 1593* where a similar attempt by HMRC to assess earlier years on this basis was rejected. The Tribunal specifically drew attention to the above issues saying:

"*The presumption goes on until there is some change. The presumption as expressed in [Jonas v Bamford] looks to the future and not the past. It is difficult to see how one can apply such a presumption based on the enquiry year to the earlier years*."

This is obviously extremely welcome but some further clarification on the issue is urgently required.

Dividends : NIC

I have previously made reference to the case of *HMRC v P A Holdings Limited* and I make no apology in returning to this really important matter having regard to the recent Court of Appeal judgment : [2011] EWCA CIV 1414.

The facts were quite complicated, but in broad terms what happened is that some employees acquired shares in a company connected with their employer. In principle (although it did not apply at the time) the receipt of the shares by the employees would represent taxable earnings.

The issue in this case was the tax treatment of the dividends subsequently paid by the company on those shares. HMRC argued that the dividends could reasonably be said to have derived from the employment and should therefore be taxed as earnings.

The First Tier Tribunal found that the dividends were correctly categorised as dividends. They also found that they could be treated as earnings but that did not stop them being dividends.

So if they were dividends and could also be earnings, there was an uncertainty about how they should be charged to tax – as dividends under Schedule F, or as earnings under Schedule E. Fortunately, the legislation recognises the possibility and deals specifically with this point.

Section 20 TA 1988 provides that dividends are taxable under Schedule F and this takes priority over charge under any other provision – for example as earnings. Section 20 (2) says:

"No *distribution which is chargeable under Schedule F shall be chargeable under any provision of the Income Tax Acts*".

This is pretty clear.

However, the Court of Appeal said it was completely wrong:

"*It is apparent that the First Tier Tribunal and the Upper Tribunal were beguiled by the provisions of Section 20 into thinking that even though the payments were emoluments, that Section required them to be taxed under Schedule F*".

This is an interesting reason for a Court falling into error – by being beguiled by the provisions of the statute.

Seeing as how that is exactly what Section 20 says, and it was intended to provide a statutory priority where income may fall within more than one head of charge, it is a bit difficult to say they were beguiled. What other interpretation could there be?

The Court of Appeal supplied the answer.

Moses LJ said that once the Tribunal had concluded that the payments were emoluments, there was no room for any further consideration of a different schedule. Therefore, they were wrong in thinking that Schedule F could even be relevant. Accordingly, the income never came within Section 20 at all. It was earnings and that was the end of it. (The Court of Appeal did not suggest that the statutory provisions should be overridden by any sort of Ramsay principle – it is just that Section 20 did not apply.)

The simplicity of this argument overlooks a rather important element that the Tribunal found that the payments were dividends as a question of fact. There seems to be no challenge to this finding of fact, merely the legal analysis which flows from it. Moses LJ could have said with equal force that the Tribunal found the payments were dividends and therefore there was no scope for the application of any other Schedule. They were dividends and that was the end of it.

This is really serious because it leaves the taxpayer in a quite impossible position. He truly had no hope.

If HMRC had wished to tax the payment as a dividend they would have an unarguable case. The Tribunal said this was the payment of a dividend, Section 20 says the dividend is taxable under Schedule F and under no other Schedule; the taxpayer would have no defence to such treatment. However, on exactly the same facts, the Court of Appeal agreed that HMRC are able to argue exactly the opposite. If this is really the correct way to approach statutory interpretation, I think we are all doomed.

Discovery Assessments

This seems to be a month for recurring themes. I am always going on about discovery assessments which continue to be a moving feast. It should not be; this is so important that the taxpayer is entitled to a bit of certainty.

It will be remembered that HMRC can raise an assessment if they discover that there is or has been an insufficiency in the existing assessments. However, the Inspector is only entitled to do so if he "*could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware*" that the amount assessed is or has become insufficient.

The question is always what the Inspector could have been reasonably expected to be aware of.

It may be remembered from last month that the cases of *Omar v HMRC TC 1559* and *Singh v HMRC TC 1544* expressed extreme views, whereas *Admirals Locums v HMRC TC 1416* was perhaps more balanced. We now have the Court of Appeal judgment in *Lansdowne Partners Limited Partnership* which is particularly important because the previous highest authority on the matter was *Langham v Veltema* also in the Court of Appeal.

In *Lansdowne*, Lord Justice Moses said that the information on the basis of which an officer ought to have been aware that the rebates had been excluded or deducted from the profits, was provided more than 10 months before the expiry of the time limit for opening an enquiry. That was more than sufficient time to obtain further information as to the taxpayers justification for exclusion or deduction and to form a legal view as to the lawfulness of exclusion or deduction. The Revenue contended that mere awareness of the facts that rebates have been deducted is not the same as awareness that the amount of the profits were insufficient.

But even if the information had been obtained shortly before the time for enquiry expired, Moses LJ took the view that an officer could have reasonably been expected to be aware that the profits stated were insufficient. The legal points were not complex or difficult. Awareness of an insufficiency does not require resolution of any potential dispute.

Lord Justice Moses went on to say:

"*I also wish to express polite disapproval of any judicial paraphrase of the wording of the condition. The statutory condition turns on the situation of which the officer could reasonably have been expected to be aware. Awareness is a matter of perception and understanding not of conclusion. I wish therefore to express doubt as to the approach of the Special Commissioner in Corbally-Stourton and Patullo namely that to be aware of a situation is the same as concluding that it is more probable than not. The statutory* *context of the condition is the grant of a power to raise an assessment. In that context the question is whether the taxpayer has provided sufficient information to an officer which such understanding as he might reasonably be expected to have, to justify the exercise of the power to raise an assessment to make good the insufficiency.*"

There are many references in this case confirming that we are looking at the awareness of a hypothetical tax officer – not the specific officer to whom information has been provided.

I am not sure that this yet entirely resolves the issue about what information is necessary, but it is a lot better than we have had before.

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