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UK Tax Bulletin

March 2012

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Introduction

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Latest Rates of Inflation and Interest

The following are the current rates from March 2012

Current Rates	March 2012
Retail Price Index: February 2012	239.9
Inflation Rate: February 2012	3.7%
Indexation factor from March 1982:	
to April 1998	1.047
to January 2012	1.996
to February 2012	(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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The Budget

A note of the main Budget proposals was issued last week since when additional information has become available regarding some of the budget measures. I set out below a few points which may be of interest:

Foreign Domiciled Spouses

It is proposed that the restricted £55,000 spouse exemption for inheritance tax in respect of transfers from a UK domiciled spouse to a foreign domiciled spouse be increased. Suggestions have been made that it is going to be increased to £325,000, but the authority for this figure is unclear.

An increase is welcome because this restriction is not widely known outside professional advisers and a UK domiciled individual with a non dom spouse is at risk of a serious charge (being virtually 40% of his worldwide assets) because of the absence of any meaningful spouse exemption. Unfortunately, an increase to £325,000, although welcome, does not really deal with the problem.

HMRC have an interesting solution which is that the non dom spouse can elect to be treated as UK domiciled for inheritance tax purposes. This is seductive and almost in the "*win with honest trifles to betray in deepest consequence*" category. It would avoid the charge on the first death, only to bring the whole of the joint assets worldwide into charge on the second death.

It may be OK if the widow is subsequently able to revoke the election and revert to her real domicile but I can hardly see that being permitted. I think this one needs watching. Much better to organise things to avoid as far as possible the risks arising from this configuration.

SDLT : Offshore Companies

The whole business of offshore companies holding UK properties has been a political hot potato - but I think the heat has obscured some underlying truths.

The perceived avoidance is that you save stamp duty land tax by acquiring your UK property in an offshore company. No you don't - you pay the full SDLT charge on acquisition. It is true that if you have an expensive property in your offshore company you can sell the company's shares to the purchaser on which he would not pay stamp duty. However, whilst this is possible, the reality is somewhat different. If you want to buy a property for £5 million and the vendor says you can buy the shares in his company instead and save yourself the SDLT you may wonder whether this is wise.

The company could well be registered in a territory where there is inadequate knowledge or security about the owners of the company and you may be able to get only scant comfort that the person who says he owns the shares really does so. And what about possible liabilities which may exist within the company. You can seek an indemnity - but how likely is that indemnity to be enforceable.

None of these problems may exist with a UK company (where the stamp duty would be only 0.5%) but then you have the problem of the inherent capital gain. If you buy the shares in the company, you inherit the capital gains tax history of the property. If it was purchased for £3 million and is now worth £6 million, you are taking over a £3 million gain upon which you will eventually need to pay tax. Not a good trade off for a tax saving of 4.5%.

Why do people do this? Well - it is not for SDLT saving for sure. It is for inheritance tax. No non dom wants to hold a valuable UK property in their personal name, because it would be chargeable to tax in the event of their death - unless it passes to their spouse, but that is not always the desired route. So it is held by an offshore company, because the shares held by the individual are excluded property and outside the scope of inheritance tax.

Putting such properties into companies for this purpose was made rather troublesome by the Finance Act 2000 which imposed a full SDLT charge on the market value (a point which seems to have been overlooked entirely by the press) and it is going to be much more troublesome now if it is going to cost 15% SDLT to secure exclusion from IHT. We will need to find another way.

In addition to all this, HMRC are contemplating a charge in respect of UK residential properties which are already held by companies. No further details are available but the Finance Bill contains an enigmatic statement concerning this suggested new charge. Clause 224 authorises HMRC to incur the expense of preparing for a new tax in respect of high value residential properties owned otherwise than by individuals.

Apparently HMRC may only incur expenditure where there is statutory authority to do so. In the case of existing taxes, the statutory authority has already been granted. However, in the case of new taxes, HMRC must receive statutory authority to incur the expenditure for the introduction of a new tax.

This sounds as if we are looking at a completely new charge.

SDLT : Transitional Provisions

There is an anomaly in the press releases between the introduction of the 7% rate on properties over £2 million and the 15% rate in respect of such properties acquired by companies.

The 7% rate applies from 22 March, and anybody exchanging contracts on Budget Day could be protected by the transitional provisions. However, the liability to the 15% charge on transfers to a company applies to transfers on or after 21 March and protection was said to be available only if the acquisition was completed before Budget Day. Although the different timing was deliberate, I understand the other differences were not and that protection is available on exchange of contracts in both cases.

Offshore Companies : Capital Gains Tax

It is proposed that UK properties are to be subject to capital gains tax if they are held by a non natural person resident outside the UK. On Budget Day it seemed likely that this did not include trustees but there are powerful suggestions that trustees are intended to be caught.

The thinking behind this is unclear. UK residents would be liable for capital gains tax anyway in respect of gains made by non resident companies because of Section 13 TCGA 1992. UK residents would also be taxable on gains made by non resident trusts because of Section 86 TCGA 1992. So it can only be intended to apply to non residents (although conceivably UK resident non doms could obtain an advantage) . But why should they be liable to CGT on UK properties held by companies, but not if they hold them personally - and what about other assets. No doubt we will be told. This is obviously a serious development - and more information is urgently required.

EMI Shares

The interesting proposal that employees who acquire EMI Scheme Shares will be able to benefit from entrepreneurs relief has been clarified by a subsequent press release.

HMRC recognised that a holder of such shares is very unlikely to meet the 5% threshold and have confirmed that individuals who dispose of shares acquired on exercising EMI options will not have to meet the 5% test.

However, all the other conditions for entrepreneurs relief will need to be satisfied - including the need to have held the shares throughout the full one year qualifying period.

This is a bit tough because many EMI Scheme Shares are effectively "exit only" and they are clearly doomed. It will be a brave shareholder who exercises his options and incurs the obligation to pay for the shares without any assurance that any funds will be forthcoming from their disposal in the near future.

It seems to me that insisting on the 12 month holding period creates such a difficulty that it just invites people to find all manner of artificial ways in which this test can be satisfied.

There was no problem in principle with the time limit commencing with the date of grant for taper relief, so I do not see why it should be so repugnant for entrepreneurs relief.

These new rules will apply where shares are acquired under an EMI scheme after 5 April 2012. I guess whatever the position, if anybody has the choice, they should exercise their EMI options after 5 April rather than before, because otherwise they are certain not to qualify for any entrepreneurs relief.

Tycoon Tax

More information about the 25% cap on unlimited tax reliefs is urgently required. Suggestions have been made that this could affect the availability of relief for trading losses brought forward and on interest relief for example in acquiring an interest in a company or partnership, or indeed for charitable donations. Whether or not these are intended to be covered by this cap is not clear - but we will know soon.

QROPS

We have a whole new set of rules relating to transfers to overseas pension schemes and some new guidance notes effective from 6 April 2012. It is possible that these are in response to the recent (and prospective) litigation - but who knows. They are extensive and complex - and I will return to the subject later. In the meantime copies are available on request.

Swiss Co-operation Agreement

It will be remembered that the Swiss Co-operation Agreement is directed at people who have secret funds in Switzerland. Unless the funds are revealed to HMRC, there will be a swingeing charge on the funds held in Switzerland and a serious withholding tax on income and capital gains in the future.

The answer is comparatively simple - make full disclosure to HMRC and these deductions will not take place. However, some people are rather anxious about making disclosures to tax authorities - not usually the UK tax authorities - because of their own personal security if they are known to have substantial wealth. The theft and sale of such information may make somebody anxious if they have family members of other business interests in countries where the rule of law and administrative integrity is not as fully developed as our own. On balance they would prefer not to place their family at risk of being kidnapped.

Anyway it would appear that there are a few problems with this agreement because the EU Tax Commissioner has threatened proceedings against the UK in respect of the introduction of this proposal as he says it is contrary to the EU rules. A Budget change has been made to incorporate the EU directive no doubt with a view to avoiding the challenge.

It is curious that amid all this controversy, Austria is trying to sign up a similar agreement with Switzerland.

Black Beer

This is a fermented beverage. It apparently has medical and nutritional benefits. It has an original gravity of 1200 degrees. It has been exempt from excise duty since 1931. I am not making this up. Anyway, it is exempt no longer.

CGT : Business Incorporations

There has been considerable uncertainty about whether the transfer of a property letting business to a company in exchange for shares, qualifies for relief from capital gains tax under Section 162 TCGA 1992.

Section 162 provides a relief from capital gains tax on the incorporation of a business. The idea is engagingly simple. If you transfer your business including all its assets (other than cash) to a company in exchange for an issue of shares, any gains arising on the business assets by reason of the transfer are effectively rolled into the shares. There are a number of interesting (and valuable) side effects to this relief.

To benefit from the relief you have to be carrying on a business. Income from property lettings is described as a business for income tax. It used to fall within Section 15 TA 1988 which said:

> "*Tax is charged under this Schedule on the annual profits arising from a business carried on for the exploitation as a source of rent or other receipts, of any estate interest or rights in or over land in the UK.*
>
> *To the extent that any transaction is entered into for the exploitation, as a source of rents or other receipts of any estate interest or rights in or over land in the UK, it is taken to be entered into the course of such a business.*"

Now the matter is covered by Part 3 of ITTOIA 2005 which uses similar wording.

So it is clear that property letting and the receipt of rents is a business - at least for income tax purposes. However, Section 162 is a capital gains tax relief and subject to completely separate legislation. The question therefore arises whether property lettings are a business for capital gains tax purposes as well. The point was recently considered by the Tribunal in the case of *Elizabeth*

Moyne Ramsay v HMRC TC 1871.

In this case the taxpayer had a house which she developed and converted into 10 flats from which she derived rents. The taxpayer said that she provided lots of services which represented a business; HMRC said the services were consistent with looking after an investment property and was not a business. The Tribunal looked at the various authorities about what represented a business and decided that on balance the activities carried out by the taxpayer were merely incidental to the ownership of the investment property and did not represent a business.

Not all together surprising perhaps. It was arguable of course but in the end it was a question of fact on the day and not really noteworthy apart from it being the first case on the application of Section 162 to property letting.

However, the curious part of the judgment was how the Tribunal set out the various arguments and the law. Naturally they reproduced the terms of Section 162 and they also set out the terms of Section 15 which applied at the time. However, having done so, they did not refer to Section 15 again. This was odd because if Section 15 was relevant - and if not, why did they specifically set out its terms under the discussion of the relevant law - then one might reasonably conclude that if a property letting business is a business for income tax purposes, it might also be a business for capital gains tax purposes. There may be good reasons why not - but none were mentioned.

Dual Contracts and Incidental Duties

HMRC have published some detailed guidance on their policy and views about dual employment contracts and incidental duties.

As far as dual employment contracts are concerned HMRC explain what they consider to be reasonable record keeping in order to establish the existence and the extent of the two contracts. They consider it reasonable for them to require access to diaries, emails, expenses claims, telephone records and client files. Whether this is in fact reasonable is perhaps open to question - but this is their view.

They ask, "in a spirit of collaborative engagement", for those employers who utilise dual contract arrangements to maintain a retention policy to retain relevant documents for at least two years from the end of the tax year to which they relate.

HMRC also set out their detailed views regarding the meaning of incidental duties. The significance of incidental duties is that where a resident but foreign domiciled individual is working full time abroad for a foreign resident employer, he is entitled to claim the remittance basis in respect of those earnings. Inevitably he may spend some time in the UK but as long as any duties performed in the UK are merely incidental to the performance of the foreign duties they will be disregarded.

HMRC recognise that having regard to current communications an employee who has an employment overseas overseas, may find it very difficult to avoid performing duties of their overseas employment when they happen to be in the UK. Responding to a telephone call or email from an overseas client would be the performance of a substantive duty of the overseas employment and would not be disregarded as merely incidental duties. So the odd telephone call or email is enough to bring the whole of the foreign earnings into charge to UK tax.

It is well known that HMRC take the view that attending a directors meeting in the UK is part of the directors core duties and cannot be regarded as incidental to duties performed abroad. Incidental duties are generally confined to reporting and liaison, preparation and anything of a non substantive nature. Reading emails would seem to be permitted, but replying to emails could be dangerous.

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There is nothing new in the statement but it has some value because HMRC confirm their clear policy that although it may be difficult for an employee to avoid performing substantive duties in the UK (by declining to answer his phone or respond to emails from overseas clients) that is not a good enough reason to revise its interpretation of incidental duties and their practice continues unchanged.

It may be wondered how this restatement of their existing practice links in with their announcement last year that they will disregard up to 10 days of substantive duties in the UK. The answer is that this 10 day concession is relevant only to the determination of an individual's resident status. Where an employee leaves the UK to work full time abroad, he will be regarded as non resident during his period of absence providing the employment covers a full tax year and he does not spend more than 90 days each year in the UK during his period of absence. Again, the requirement is for full time employment and incidental duties can be disregarded - but for this purpose only. HMRC will also disregard up to 10 days of substantive duties in the UK without interfering with the employees non resident status. This is very valuable, but this concessionary treatment has no application at all to UK residents and the charge to tax on employment income.

Twitter : On Line Traders

Last week, HMRC held a Twitter Q & A for on line traders who might not have paid all their taxes. There is a special disclosure opportunity for on line traders (with a promise of a 10% penalty) which runs out on 14 June and I guess they want to reach as many opportunists as possible. I am impressed. How very modern. Maybe we will have an App soon.

I missed it unfortunately; I was reading a book - one of those things with pages.

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