UK Tax Bulletin

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Introduction

Current Rates: .... Latest rates of inflation and interest

Economic Reality: .... HMRC attempt to tax a void transaction

Annual Tax on Enveloped Dwellings: .... HMRC issue a guidance note

Discovery: .... The waters are muddied - again

Principal Private Residence Exemption: .... Further judicial guidance

Gambling Tax : The Future?: .... A move to tax on the place of consumption

Corporate Residence: .... A view from another angle

Latest Rates of Inflation and Interest

The following are the current rates at August 2013

Current Rates	August 2013
Retail Price Index: July 2013	249.7
Inflation Rate: July 2013	3.1%
Indexation factor from March 1982:	
to April 1998	1.047
to May 2013	2.147
to June 2013	Not yet published
to July 2013	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

Since 6 April 2010: 4%

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Economic Reality

The recent case of *Russell Baker v HMRC TC 2790* raises some interesting issues. On the face of it, everything seemed reasonably straightforward – but not for long.

Mr Baker received a payment of £120,000 from his company which was intended to be a purchase by the company of its own shares. Unfortunately, quite a lot went wrong with the arrangements. The statutory conditions for a lawful purchase by a company of its own shares were not satisfied – for example there were insufficient distributable profits and it was generally in breach of some relevant parts of the Companies Act 1985. It seemed clear that the transaction was void, but HMRC took the view that even so, this £120,000 could still be taxed as a distribution.

HMRC suggested that Mr Baker should be taxed on the basis of "economic reality". He had received the money from the company for his shares and "the tax treatment must follow the economic reality" (sic). The fact that the payment could not lawfully be a dividend and that the statutory conditions for it to be treated as a dividend were not satisfied, did not seem to represent any kind of impediment to HMRC.

Life is too short to permit an analysis of all the implications of such an approach but a few obvious points arise. For example, there is not much point in having statutory rules if it does not matter whether you satisfy them or not. It might even be said that seeking to levy taxes on such a basis would be arbitrary taxation. That has been thought to be wrong for quite a long time – like since the Bill of Rights 1689.

If HMRC can argue that taxes can be levied on the basis of economic reality and without regard to the satisfaction of any statutory rules, this might perhaps be really helpful to the taxpayer. I don't think so. The acid test would be to look at this argument the other way round. What if the taxpayer had said to HMRC: I want this payment to be treated as a dividend (because that would be to my advantage) but unfortunately, it is unlawful for it to be a dividend and I have not satisfied any of the statutory tax rules for this treatment, nor have I satisfied any of the Companies Act rules – but I would still like it treated as a dividend. I expect HMRC would soon change their mind about this being a good argument – when they had stopped laughing.

It was a relief to find that the Tribunal Judges did not think much of the economic reality argument – nor did they think that a void transaction could be recategorised into anything else. It was void, it never happened, and any money received by Mr Baker needed to be returned to the company.

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Annual Tax on Enveloped Dwellings

HMRC have issued a 79 page technical guidance note on the Annual Tax on Enveloped Dwellings. This is a very comprehensive document and extremely helpful. It covers all aspects of the ATED, with extensive references. I have not found anything particularly controversial.

The guidance makes it clear that there is an important distinction between being outside the scope of the tax, and being protected by a relief. If the company is claiming a relief from the tax, for example on the basis that the dwelling is let on a commercial basis to an unconnected party, it must submit a return and claim the relief. It is not enough to say that the property will be let - that is to say the entitlement to the relief is only prospective. In that case, you have to submit the return, pay the tax, and subsequently claim a refund when the conditions for the relief are satisfied.

It will be remembered that the tax starts at £15,000 a year for properties worth more than £2 million, £35,000 a year for properties worth more than £5 million and rising to £140,000 a year for properties worth more than £20 million.

HMRC highlight one rather alarming aspect of the tax which arises where a property is owned by a company jointly with another person. Where a company is jointly entitled to an interest in the property, the tax applies in respect of the whole interest, and not just the company's share. This is made clear by an example:

> "*A company beneficially owns 10% of the single dwelling interest (either as joint tenant or in partnership). The single dwelling interest as a whole is worth £5 million. The company is jointly and severally liable for the ATED for the band appropriate to a £5 million valuation and not just for its 10% proportion. The company must complete the ATED return and pay the tax [which will be £15,000].*"

The amount of tax applicable to each of the value bands is to be indexed for 2014/15 by reference to the Consumer Price Index. This was flagged at the outset but it still might come as a surprise because it is a bit counter intuitive. You might have thought that the value of the properties would be indexed so as to keep the tax at the same level in real terms. Dream on. The property value bands stay the same (and therefore bring more and more properties into charge each year) and the rate of tax increases by inflation - a kind of double whammy.

An ATED return must be made within 30 days of the date when the company first comes within the charge to the tax. The ATED return for the current year 2013/14 must be submitted by 1 October 2013 and the tax paid by 31 October. The next return, for 2014/15 must be submitted by 30 April 2014 and the tax must be paid at the same time.

Discovery

Another important case has appeared on this subject: *Robert Smith v HMRC TC 2768*. In December 2012 the decision of the Upper Tribunal in *Charlton v HMRC* reviewed all the issues and authorities regarding discovery assessments, but *Smith* looks like a step back.

A crucial element of the decision in *Charlton* related to Section 29(5) Taxes Management Act 1970 which enables HMRC to make a discovery assessment outside the enquiry window if an officer of HMRC could not have been reasonably expected on the basis of the information made available to him before the deadline to have been aware of the insufficiency in the self assessment. It is this awareness test which always causes trouble. Whenever HMRC miss the deadline, they always claim that they did not have sufficient awareness of the relevant matters so the deadline does not apply to them.

The issue in *Charlton* surrounded a tax avoidance scheme for which there was a DOTAS number. The Upper Tribunal concluded that the reference to the DOTAS number indicated clearly to the HMRC officer that this was an avoidance scheme and that the necessary forms filed as a result of the disclosure provided all the relevant information.

Unfortunately, the test articulated in *Charlton* was impossibly subjective. The officer of HMRC referred to in Section 29(5) is not the actual officer who received the information but a hypothetical tax officer of reasonable knowledge and understanding - but there is no uniform standard. We are not looking at an officer of only general capability and experience nor of an ordinarily competent Inspector. We are looking at an officer who is assumed to have a sufficient level of understanding under the circumstances. With all respect to the Tribunal, this could mean anything.

It may have been thought that as *Charlton* was a tax avoidance scheme and therefore the least sympathetic category of cases likely to be considered by the Tribunal, the problems arising from such a subjective test would not arise in the majority of cases.

However, the case of *Robert Smith* throws everything up in the air again. This too was a tax avoidance scheme but there was no DOTAS number so we have to consider whether the information actually provided to the hypothetical officer satisfied the awareness test.

This is a real trap for the taxpayer because the only information which can be taken into account is that actually provided by the taxpayer himself. The fact that HMRC may know all about the scheme and have every conceivable piece of documentation does not matter. If that information did not come from the taxpayer it does not count. In the case of *Smith*, HMRC clearly knew all about the scheme. Indeed they had written a detailed technical memorandum on its effectiveness and had placed a message on a noticeboard for all tax officers stating that the scheme was to be challenged. They also had enough information to raise assessments on 51 taxpayers who used the same scheme and the only reason they did not do so in the case of Mr Smith was because someone was sick and the matter got overlooked.

Nevertheless, despite the fact that HMRC knew all about it, had issued the technical memorandum, had warned all their Inspectors, had issued assessments to 51 taxpayers, they were still able to claim that they had insufficient awareness of the scheme in the matter to raise an assessment on Mr Smith.

It will be interesting to see where matters go from here. We are quite some way from a consistent (and comprehensive) code in respect of discovery issues and this will only promote further litigation.

Principal Private Residence

There has been yet another case on this subject: *Piers Moore v HMRC* PC2827.

This is the latest in a line of cases on this exemption, not so much about whether a property was a taxpayer's only main residence for capital gains tax purposes but whether the property was "a residence" at all. On the interpretation which has developed, it is going to be very difficult indeed for a property to qualify as a residence.

We might start with Lord Widgery's celebrated description of a residence in the case *of Fox v Stirk (1970)*:

> *"a place where a man is based or where he continues to live, the place where he sleeps and shelters and has his home. It is imperative to remember in this context that residence implies a degree of permanence. Consequently, a person is not entitled to claim to be resident merely because he pays a short temporary visit. Some assumption of permanence, some degree of continuity, some expectation of continuity is a vital factor which turns simply occupation into residence".*

This approach was adopted by the Court of Appeal in *Goodwin v Curtis 70 TC 478* confirming that the occupier has to show some degree of permanence and some expectation of continuity; temporary accommodation at an address does not make somebody resident there. However, in *Goodwin v Curtis*, the taxpayer only occupied the property for 5 weeks. He had just separated from his wife and stayed in the property as temporary accommodation – and two days after moving in he purchased another property which he intended to be his main residence. He lost.

That seems fair enough until we get to the case of *Susan Bradley v HMRC TC 2560* who separated from her husband, moved out of the matrimonial home and moved into another house that she owned. She repainted it, undertook some improvements, generally made it more of a home. Although she put the property on the market, the market was very poor and she expected to live there permanently. After 8 months she was reconciled with her husband and moved back into the matrimonial home. The Tribunal found that her occupation was only temporary; she had put it on the market and it was never her residence at all.

Compare this with *David Morgan v HMRC* TC2596. Mr Morgan was purchasing a property where he intended to live when he and his girlfriend were married. However, they broke up; he carried on with the purchase, moved in for 2 weeks specifically to prepare the house for renting and then moved in with his parents. The Tribunal found that this was his residence.

Where on earth do you go from here?

You go to Piers Moore. Mr Moore also had matrimonial difficulties and moved into another property. He took furniture with him from the matrimonial home and bought some more. He took all his clothes knowing that he would never return to the matrimonial home. He lived there from November 2006 to July 2007 spending pretty much every night there except when he was away on business. The property was sold to meet the requirements of the matrimonial settlement.

Mr Moore took up with another lady (whom he subsequently married) and they purchased another property to be their main residence to accommodate his new wife and step-children.

Sometime later, Mr Moore wrote to HMRC acknowledging that he lived in the property at 110 Headlands between 12 November 2006 and 12 July 2007, describing his occupation there as temporary. Oh dear. Fatal! Of course it was temporary; it could hardly be permanent - he had already moved out.

Mr Moore had lived in the property for 3 – 5 months before it began to be marketed and the purchase of a new property with his new family was initiated almost 6 months after he had moved into the property. The Tribunal found that Mr Moore did not occupy the property with sufficient degree of permanence for it to be a "residence". It was only temporary accommodation that did not amount to a residence.

I suppose we must consider the case of Morgan as an aberration and conclude that a person will only acquire a residence if he has absolutely no intention of ever leaving the property and that there are no foreseeable circumstances in which he might move out - like getting married, having children or accepting responsibility for step-children which might make the house unsuitable and necessitate moving to a larger house – or conversely getting divorced and moving to a smaller house. I am not sure what you do if there are two properties because it may be difficult to establish the necessary degree of continuity for either of them – despite the fact that the legislation clearly recognises that this can be the case and provides for an election to be made in these circumstances.

Furthermore, it is clear from Piers Moore that when the expectation of continuity ceases (when you decide that you would like to move to a bigger house) the existing property ceases to be a residence at all.

So how do we answer the question: I have bought a new house where I am going to live, will it be regarded as a residence? Sorry, not a clue. Maybe if you occupy for two weeks and then rent it out, that would be OK. But, if you live there exclusively for 8 months without any wish or intention of moving, then definitely not. Um.

I think maybe the time has come for an authoritative decision setting out clear guidelines about what represents a residence, so that taxpayers (and their advisers) can know where they are.

Gambling Tax : The Future?

There has been a great deal written recently about where international companies pay their taxes - the general theme being that if they pay tax in another jurisdiction that is absolutely unacceptable.

The gambling industry is one activity where profits can arise in many different countries (and often predominantly in a country which does not have a high tax rate) and HMRC now have them in their sights. It is proposed that the UK will tax remote gambling companies on their gambling profits made in the UK. These reforms will be limited to changes in general betting duty, pool betting duty and remote gaming duty.

This is not going to be an easy matter, not least because of the detailed record keeping which will be required but the general idea is that overseas operators will account for duty on the gross gambling profits generated from UK customers - that is customers who usually live in the UK.

In addition, remote gaming duty will be charged on the provision of facilities for remote gaming to customers in the UK.

And they are going to some lengths to ensure collection. Possibly having regard to the difficulties involved in collecting the tax, the penalties for non compliance will be unbelievably serious - like a prison sentence and an unlimited fine.

These new rules are not intended to come into force until next year and may well be modified before that time and further information is available on request to anybody who is concerned with these proposals.

I guess this could be the first step in a movement to the place of consumption as the basis for taxation.

Corporate Residence

I have been reading the rather interesting case of *Vava v Anglo American South Africa Limited [2013] EWHC 2131.* It dealt with the meaning of the place of central administration of a subsidiary company, not for tax purposes, but for the purposes of jurisdiction under Regulation EC44/2001 on Jurisdiction under Recognition and Enforcement of Judgments.

The Court acknowledged that the parent may have influenced (even strongly influenced) the subsidiary in its decision making process but as long as it did not usurp the authority of the board of the subsidiary, the place of central administration of the subsidiary would not be located with the parent.

It does not take us much further regarding the meaning of corporate residence and the traditional tests for central management and control which apply for tax purposes, and the principles now well established in *Wood v Holden [2006] STC 443* and *Untelrab v McGregor SpC 55*, but it is interesting that similar reasoning applies in a commercial context.

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