SQUIRE SANDERS

TAXING MATTERS

Peter Vaines navigates the stormy waters of tax

The Finance Act 2013 came into force on 17 July and with it a number of new provisions. One of the most important is the general anti abuse rule (GAAR) which applies to tax arrangements taking place after that date.

GAAR

Where arrangements are entered into with a main purpose of obtaining a tax advantage, they will be regarded as abusive (and therefore subject to counteraction) if they "cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions".

I may not be the first person to observe that the term "abusive" is therefore being defined as unreasonable, which many may feel is not the same thing at all.

You therefore need to consider whether what you are doing is intended to exploit any shortcomings in the legislation and whether it involves any contrived or abnormal steps. You also have to consider what policy objectives should be implied by the legislation. I don't know how the ordinary taxpayer is supposed to do that—but never mind. Unfortunately, it is not enough to come to a sound and honest view of these matters. You have to second guess what HMRC will regard as reasonable (or doubly reasonable) and what policy objectives were implied. Good luck with that.

If HMRC think that there have been abusive tax arrangements which ought to be counteracted, they will ask the taxpayer to explain why not. HMRC cannot just take counteractive steps immediately. They must first refer the matter to the GAAR Advisory Panel who will express their view. Sounds good—but it will not help. If the GAAR Advisory Panel says the transactions are OK, HMRC are free to proceed anyway if they do not agree with the panel (and as HMRC will have already decided that the arrangements are abusive, they are hardly likely to change their mind).

You will not want to know this next bit. If the matter goes to court, the court must take into account the HMRC guidance in deciding what it all means.

I wonder where this leaves me on my proposed trip to Paris. I do not want to pay the airline passenger tax (APT) and solely for this reason, I travel by Eurostar. Avoiding payment of the tax is my main reason for making the arrangements to go by train. There is clearly a shortcoming in the legislation (the APT does not apply to trains) so my deliberately contrived arrangement should fail and HMRC should charge APT.

It won't of course. Parliament did not intend that APT should be charged in these circumstances. Who says so? But it's obvious …. isn't it? Well actually no.

Anyway, it is no good complaining. This is the law now and it will be very interesting to see how this plays out.

IHT: Non domiciled spouse election

A foreign domiciled spouse now has an opportunity to elect to be treated as UK domiciled to avoid the application of the restricted spouse exemption (now £325,000) where they inherit assets from their UK domiciled spouse.

This is an extremely valuable relief because the restricted spouse exemption has been a source of genuine anxiety for many couples who simply (and sadly) assumed that because they were married there would be no inheritance tax on the first death.

This election may sound like putting your head in the lion's mouth, because by making the election the spouse is thereupon treated as UK domiciled and within the scope of inheritance tax on the whole of their worldwide assets. Fortunately, this risk has been largely removed because if the surviving spouse is non-resident for four tax years following the election, their non domiciled status resumes. This will be a very welcome relief—but it is not all plain sailing as a recent explanatory note by HMRC makes clear.

They give an example of a husband who transfers £1m to his foreign domiciled wife. Subsequently (and independently) she transfers some of her foreign assets to an offshore trust. If her husband dies she could make the election to be treated as UK domiciled so that his gift to her benefits from the spouse exemption. However, by doing so, she is treated as domiciled in the UK for all IHT purposes and her independent transfer of her foreign assets to a foreign trust becomes a chargeable transfer.

This is a real trap and could put her in serious difficulty.

A problem could arise if the husband had made the gift more than seven years ago. It would no longer be a potentially exempt transfer (PET) but it could be a gift with a reservation unless the wife had made quite sure her husband was excluded from any benefit from the subject matter of the gift. If not, the asset would be treated as remaining in the estate of the donor. There would be no spouse exemption on death because the asset would not pass on death. Nor would one of these new elections help for the same reason. You can make an election in respect of a failed PET, but this is not a failed PET so the non-dom spouse ends up with a real and unexpected problem.

In principle this is a very useful election— but there are lots of stings in its tail.

Annual tax on enveloped dwellings

HMRC have issued a 79 page technical guidance note on the annual tax on enveloped dwellings (ATED). This is a very comprehensive document and extremely helpful. It covers all aspects of the ATED, with extensive references.

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.

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 £5m. The company is jointly and severally liable for the ATED for the band appropriate to a £5m valuation and not just for its 10% proportion. The company must complete the ATED return and pay the tax."

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 in addition, 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.

Principal private residence

I mentioned a couple of recent decisions on this subject last time but things have got worse (see "Taxing matters", NLJ, 5 July, p 16). The way this subject has developed it is going to be very difficult indeed for a property to qualify as a residence at all.

We might start with Lord Widgery's celebrated description of a residence in the case of Fox v Stirk [1970] 2 QB 463, [1970] 3 All ER 7: "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 simple occupation into residence."

This approach was adopted by the Court of Appeal in Goodwin v Curtis [1998] STC 475, 70 TC 478, although in that case the taxpayer only occupied the property for five 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 [2013] UKFTT 131 (TC) who separated from her husband, moved out of the matrimonial home and moved into another house that she owned. She made some improvements and 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 eight 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. This must be stretching Lord Widgery's test of "a short temporary visit" to breaking point.

Compare this with David Morgan v HMRC [2013] TC 02596. Morgan was purchasing a property where he intended to live when he and his girlfriend were married. Unfortunately, they broke up but he carried on with the purchase, moved in for two 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 v HMRC [2013] UKFTT 433 (TC). 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.

Moore took up with another lady (whom he subsequently married) and later purchased another property to be the main residence for his new wife and step-children.

In correspondence with HMRC, Moore described his occupation as temporary. Oh dear. Although he had lived in the property for some months before it was marketed and the purchase of a new property with his new family was initiated six months after he had moved into the property, the tribunal found it was only temporary accommodation and not a residence.

I think we must now conclude that a person will only acquire a residence if he has no intention of ever leaving the property and that there are no foreseeable circumstances in which he might move— like getting married or having children which might necessitate moving to a larger house.

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 in it as a home exclusively for eight months without any wish or intention of moving, then definitely not.

I would suggest that the time has come for an authoritative decision setting out clear guidelines about what represents a residence, so that taxpayers can know where they are.

Peter Vaines
T +44 20 7655 1780
E peter.vaines@squiresanders.com

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