UK Tax Bulletin

November 2013

Introduction

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Latest Rates of Inflation and Interest

The following are the current rates at November 2013

Current Rates	November 2013
Retail Price Index: October 2013	251.9
Inflation Rate: October 2013	2.6%
Indexation factor from March 1982: to April 1998 to September 2013 to October 2013	 1.047 Not yet published 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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Residence I

The recent case of *Mr & Mrs Rumblelow v HMRC TC3022* is one of many residence cases under the old rules. This case has no relevance to the present position now that we have the Statutory Residence Test but there are many other cases like this one waiting in the wings.

The problem of course is that residence cases are almost always critically dependent upon their own facts. Arguments on the underlying principles are in short supply, although after all the interminable litigation, the principles should be pretty clear. You would have thought so.

Mr & Mrs Rumblelow went to Belgium immediately prior to 5 April 2001 and subsequently set up home in Portugal. The issue was whether they had made a distinct break from the UK – which we know from Lord Wilson's judgment in *Gaines-Cooper* means whether there had been a substantial loosening of their ties with the UK.

The Tribunal highlighted Lord Wilson's judgment in *Gaines-Cooper* and the need for a multi-factorial enquiry. The Tribunal was critical about the casual way Mr & Mrs Rumblelow had gone about things relating to their departure and concluded that, as a question of fact, their ties were not loosened sufficiently to justify a conclusion that they had ceased to be resident in the UK.

That is clear enough. Game over.

However, the judgment contained a thirteenth chime. The Tribunal said it was curious that the taxpayers were unable to provide any documentary evidence about how they monitored their visits to the UK "to ensure that they did not breach the permitted maximum days in booklet IR20".

WHAT? This is so wrong on so many levels. The Tribunal had considerable regard to the decision in *Gaines-Cooper* – but seem to have overlooked that a central (and absolutely fundamental) element of the *Gaines-Cooper* litigation was that there was no permitted maximum number of days in booklet IR20. There was a wide-spread belief that if you went abroad and did not come back for more than 90 days in the subsequent years, you were safely non-resident. However, we were all mistaken. Whether we like it or not, the Supreme Court have told us that to interpret IR20 as meaning that there was a permitted maximum number of days was to misunderstand the guidance completely.

And what has IR20 got to do with the Tribunal anyway? We know (and the Tribunal acknowledged) that IR20 was just the HMRC practice at the time and it was not a statement or summary of the law and had no place in the proceedings - let alone in the judgment.

The fact that the taxpayers did not provide any evidence to "ensure that they did not breach the permitted maximum days in booklet IR20" formed a specific part of the Tribunal's decision. We do not know how important this thinking was, but if it was not influential in the Tribunal's decision, Mr & Mrs Rumblelow are entitled to wonder why it was referred to as one of the elements under the heading of "Decision" in the first place.

Residence II

There has been another case on residence heard by the First Tier Tribunal: *James Glyn v HMRC TC 3029*. The issue was essentially the same as in the case of Mr & Mrs Rumblelow. Mr Glyn left the UK to take up residence in Monaco in early April 2005 and the Tribunal had to decide whether he had made a distinct break. Was there a substantial loosening of his ties with the UK?

Again, the decision was crucially dependent on the particular facts of the case. The Tribunal reviewed all the facts in exhaustive detail (conducting the necessary multifactorial evaluation) and came to the conclusion that Mr. Glyn had made a distinct break from the UK by substantially loosening his social and family ties and therefore become non-resident.

This is not just any old case which happened to go in the taxpayers favour. This is **REALLY IMPORTANT** because it is the first residence case won by the taxpayer since the dawn of time. Well, since Dave Clark won in *Reed v Clark* which amounts to the same thing. (True, Mr Grace won before the Special Commissioners, representing himself (and well done him), but that did not last long because he went down in flames on appeal.)

The Tribunal acknowledged that although Mr. Glyn was labouring under a misunderstanding about the meaning of IR20 and he had accordingly limited his visits to the UK, this did not really affect anything; what mattered were the facts. Nevertheless, the Tribunal was very robust in its criticism of IR20 describing it as hopelessly misleading, and that it lulled Mr. Glyn into believing that his visits to the UK would not jeopardise his non-resident status. Such criticisms are perhaps no longer relevant going forward, but they may well have a bearing on other cases which are coming along behind.

The Tribunal was also critical of the HMRC methodology in counting days. You will remember the idea that in counting days in the UK you ignored days of arrival and departure because that is what it said in IR20. No, no, no – it does not mean that at all. There was never such a rule for counting days when people leave the UK; anybody who thought so (er, like everybody) had completely misunderstood. The practice of HMRC in residence cases has been to count all days, including days of arrival and departure, however short the time spent in the UK. The Tribunal did not think much of this either.

Not that any of this really matters because on the facts Mr. Glyn had made a distinct break, but I imagine HMRC might still want to appeal. They will have a problem overturning the decision which seems to be entirely a question of fact. On *Edwards v Bairstow* principles, HMRC would have to show that no person, acting judicially and properly instructed could have reached that conclusion on the facts. Tough call but I expect they will try anyway, if only to get rid of the criticisms.

Penalties for Carelessness

HMRC are (not unnaturally) rather keen on penalising people who do not give due care and attention to their tax affairs. The old ideas of negligence and negligent conduct have been replaced by carelessness - and this is defined by schedule 24 (3) Finance Act 2007 as a failure by the taxpayer to take reasonable care. That is usually how one would define negligence but never mind.

It has become pretty clear that where somebody has taken professional advice and relied on it in connection with their affairs, that will protect them for any penalty on the grounds they would have taken reasonable care. This has been established in recent cases such as *Rowland* and *Hanson* and now by *Elizabeth Mariner v HMRC TC 3039*. HMRC have continued to press this point, mainly I think to probe the taxpayers conduct to make quite sure that there was no carelessness even though professional advice has been obtained.

HMRC were emboldened in their approach by the decision in Wald v HMRC (2011) in which the Tribunal decided that the taxpayer remains responsible if there are errors in his tax return due to the negligence of his accountant whilst acting on his behalf. That is all very well; of course the taxpayer is responsible, but if nothing else, instructing a professional adviser provides a reasonable excuse which provides an equally effective defence.

The position was reviewed in *Elizabeth Mariner v HMRC* where the Tribunal said that the taxpayer could not be principally or vicariously liable for the negligence of her professional adviser unless the circumstances indicated the matter was fraught with difficulty and doubt. It is contrary to the very notion of reasonable care that a person who perceives a need to take professional advice can be said to be negligent if she then relies on that advice - even it is turns out to be wrong.

However, this is not a get out of jail free card because if the taxpayer has reason to believe that the professional adviser may be not be correct, he cannot just close his eyes to those doubts and hide behind the adviser.

Interestingly, a second case on this point was published this month: *Stratton v HMRC TC 2967* in which the Tribunal reaffirmed the test for negligence in this context as being as follows:

"the test to be applied is to consider what a reasonable taxpayer exercising reasonable diligence in the completion and submission of his return, would have done".

In this case the taxpayer received advice from his accountant that an amount was not chargeable to income tax but he was also aware of guidance from HMRC that it was taxable. Faced with the discrepancy, he should have at least enquired into the matter, from which it would have been discovered that there was no reasonable basis for the view taken by his accountants.

The Tribunal went on to consider whether he had a reasonable excuse. They concluded that where there is no reasonable basis for the advice or the advice was based on a simple failure to consider the relevant statutory provisions, reliance on such defective advice cannot constitute a reasonable excuse.

This seems seriously harsh. How on earth is the taxpayer to know whether the advice was defective or whether the adviser considered the relevant statutory provisions. Not a clue. If this is right it undermines the whole purpose of (and protection arising from) taking professional advice. I would suggest this goes too far.

EIS Investments

The Tax Tribunal recently had to consider what is meant by money being employed wholly for the purposes of a business for the purpose of the Enterprise Investment Scheme in the context of a subscription of shares.

In *Harveys Jersey Cream v HMRC TC 3045* the company was a partner in a trading partnership and generally qualified for the EIS. The company raised money by issuing further shares and increased its interest in the partnership. HMRC said that to qualify for EIS relief on this subscription there are two key conditions:

a) the shares must be issued in order to raise money for the purposes of the qualifying business activity; and

b) all the money raised by the issue of shares is employed wholly for the purposes of that activity within specified periods.

The difficulty was that the money raised by the issue of shares was not employed in the business at all but was paid out to the other partners. HMRC said that this disqualified the subscription from EIS relief and the Tribunal agreed.

The decision seems unarguable but some of the reports of this case seem a bit alarmist. The Tribunal did say "getting a bigger share of the trade is not an activity of the trade" and although that was clearly right in the context of this case, it will not always deny relief. As always, it depends how you do it. If the taxpayer had acquired a bigger share of the trade and the funds provided for that acquisition were actually used in the business then there is no reason to believe that relief would not be available. It would certainly not be denied by this decision.

Foreign Domiciled Spouses: IHT

The inheritance tax problems associated with the restricted spouse exemption where a transfer is made from a UK domiciled spouse to a foreign domiciled spouse have been widely discussed. Some of the problems have been resolved by the election which is available from 6 April 2013 to the non-domiciled transferee spouse. This election enables the transferee spouse to elect to be UK domiciled for the purposes of inheritance tax and thereby benefit from the full spouse exemption in respect of assets inherited from the UK domiciled spouse.

This election is not without its problems but it still represents an extremely valuable relief and is very welcome in eliminating the anxiety which previously arose from the possibility of a crippling inheritance tax charge on the death of the first spouse.

However, there has for some time been a strong body of opinion suggesting that the denial of the full spouse exemption to the foreign domiciled spouse was unlawful anyway as it breached various articles of the EC Treaty, not least article 56 being a restriction on the freedom of movement of capital.

This is all very well, but ordinary taxpayers in the UK are naturally a bit reluctant to assume that they can invoke the EC Treaty to escape a clear and long established set of rules in our domestic legislation.

The case of Veramattner (C-510/08) was very helpful but we have another one now: Welte v Finazant

Velbert (C-181/2012) where a Swiss national was denied an inheritance tax exemption in respect of property situated in Germany because the he was not resident in Germany.

It looked like an open and shut case and despite the German government arguments that this discrimination was justified, the CJEU said it was not. If the decision holds good for the UK, it could render the FA 2013 election completely unnecessary. In any event, in circumstances where making the election causes of other tax difficulties (for example those highlighted in the September Tax Bulletin), maybe we can get the best of both worlds.

Private Residence Exemption

I have written quite a lot recently on the main residence exemption for capital gains tax and the difficulties in ascertaining what represents a residence for this purpose. That uncertainty continues. However, HMRC are now pursuing another tack which appeared in the recent case of *Dickinson v HMRC TC 3027*.

The taxpayer had a house and garden which included a tennis court. She sold part of the tennis court to a developer (it must have been some tennis court because the developer was going to build four houses on it. Anyway I digress). HMRC claimed that this disposal did not benefit from the main residence exemption in section 222 TCGA 1992 which provides an exemption for the disposal of:

a) a dwelling house or part of a dwelling house which is, or has at any time in his period of ownership being, his only or main residence, or

b) land which he has for his own occupation and enjoyment with that residence as its garden or grounds up to the permitted area.

HMRC argued that when the land was sold (i.e. when contracts were exchanged) the taxpayer no longer had the land for her own occupation or enjoyment with her residence because it had become a building site and could no longer be regarded as garden or grounds.

It is relevant to this argument that (a) above refers to the dwelling house which is, or has at any time during his period of ownership been, his only or main residence, whereas (b) refers to "land which he has for his own occupation and enjoyment". The use of the present tense means that the occupation and enjoyment of the land must continue until the moment of sale.

One might think section 223(1) would be helpful as it says that the gain is exempt if the dwelling house had been the only or main residence throughout the period of ownership, or throughout the period of ownership except for all or part of the last thirty-six months. In other words you get three years to sell the property after you have moved out without losing any of the exemption. However, this refers only to the dwelling house and not to the garden or grounds.

The underlying thinking here is clear enough. If I have a house and I sell part of my garden then the gain on that disposal qualifies for the exemption. If however, I sell my house and most of the garden but hang to a bit of garden and sell it later, the subsequent sale of that piece of land will not qualify for the relief because it is not a residence and neither is it the garden or grounds of a residence - the residence has already gone. This was the substance of the decision in *Varty v Lynes 51 TC 419*.

However, in the case of Mrs Dickinson she was still living in the house and certainly the tennis court had been part of her garden or grounds - it was just that before contracts were exchanged, she let the developers in to dig up the tennis court. (The fact that she controlled the development company does not affect the position.) HMRC said this meant it was no longer part of her garden or grounds and relief should be denied.

Surely not. My garden may be a mess but it still my garden; it may be being dug up but while I own it, it is still my grounds which I have for my own occupation and enjoyment with my residence. That status must surely continue until it is disposed of, so I must surely be entitled to the exemption.

But HMRC had another argument. They said that by allowing the developers to dig up the tennis court before exchange of contracts this gave rise to some kind of disposal so that by the time contracts were exchanged Mrs Dickinson no longer had the property at all. The Tribunal did not think much of this either. Accordingly, Mrs Dickinson was entitled to her relief. (If the developer entering on to the land and commencing work did cause a disposal for capital gains tax purposes, then the relief must have surely still been available for the same reasons.)

Such a literal interpretation sems hardly justified in a relief of this nature. Indeed it is wholly inconsistent with section 223(1) and the allowance of the extra thirty six months. During that three year period after the taxpayer has moved out but before the property has been sold, he will not be in occupation (except in a very technical sense) but he certainly will not be enjoying it because he is living somewhere else. Accordingly, on the HMRC argument, during that three year period, the exemption continues for the house, but not the garden. Fortunately, the Manuals shows that HMRC do not take this point, but their stance seems rather inconsistent in the context of this case.

Remittances

HMRC have published some new pages to the Residence, Domicile and Remittances Basis Manual to explain how the remittance basis works and to provide a number of practical examples. These are exactly the same as the examples included in a letter which they were sending to foreign domiciled taxpayers earlier in the year.

The examples provided by HMRC in that letter came in for some criticism as some are seriously doubtful but they have not taken any notice. One or two other examples have caught my eye.

HMRC say that a remittance will include the purchase overseas of a return air fare from New York to London using your foreign income. The reasoning is that the airline provides a service of flying you from New York to London, it lands in the UK and in due course it takes off again. One can see that part of the service of the airline is enjoyed in the UK. However, this is much too simple. Let us assume that the flight was not from New York to London but from Paris to Dublin. To fly from Paris to Dublin you have to fly through the UK airspace. It is long established that the UK extends from ground to the heavens so the flight would partly be enjoyed in the UK. So the cost of flight, purchased out of foreign income would be a remittance. Obviously this is nonsense. Even if section 809L FA 2008 can be interpreted in this way it does nobody any good to perpetuate such absurdity.

If you think that is bonkers, try this next example:

"You make a gift of some of your foreign income to your adult son or daughter who lives abroad. Three years later your child gives some of these funds to their sixteen year old child (your grandchild) who spends the money during a visit to the UK."

That is a taxable remittance. Are they having a laugh? Actually, if this is a serious point, it is much worse. Let us assume that the son did not give any of the money to the grandchild but bought them some socks and a suitcase. The child travels to the UK wearing the socks and carrying the suitcase. Fortunately, the money spent on the socks is not taxable because it is exempt property "clothing, footwear, jewellery, and watches" within the terms of section 809X. However, the suitcase is not covered by the exemption so the cost of the suitcase represents a taxable remittance for the father. If HMRC are serious that the rules are really intended to operate in this way, we are all doomed.

QROPS

On 27 November HMRC issued a statement saying that (in the absence of fraud or dishonesty) any transfers made before 24 September 2008 to a pension scheme which was included in the HMRC QROPS list will not be subject to an authorised payment charge.

I will save my comments on this until next month because by then we might have received the judgment of Charles J in the judicial review case of *R (on the application of Gibson) v HMRC* which was heard in June this year. This matter is still potentially explosive. Stay tuned.

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