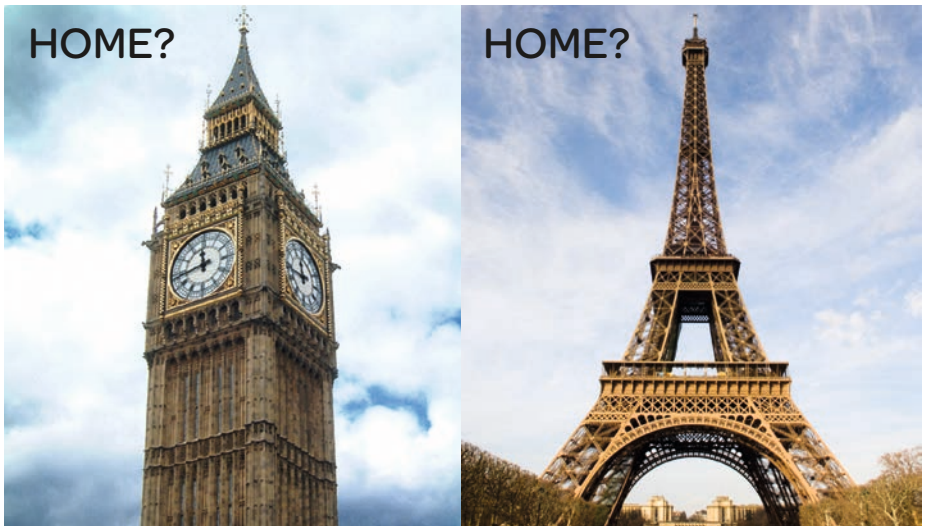
Taxing matters

Peter Vaines reports on a double dose of residency tests, the tax consequences of void transactions, penalties & costs



IN BRIEF

- Under the automatic UK residence test, being in the UK for 30 days can be enough to make you resident, even if you have another home abroad.
- The tribunal can award costs if one of the parties has acted unreasonably in bringing, defending or conducting the proceedings.
- The tax effects of a transaction are annulled retrospectively if a voidable transaction is declared void.

It will take time before the uncertainties in the new statutory residence test are resolved and it is only residence nerds who will keep agonising over all the various technicalities now. However, occasionally, something important pops up which deserves wider comment.

Under the automatic UK residence test, you will be conclusively UK resident if you have a UK home which is available to you for more than 91 consecutive days and you spend more than 29 days in it. So being in the UK for 30 days can be enough to make you resident. This could be an unpleasant surprise.

This will not apply if you have an overseas home where you spend more than 29 days during the year. However, a holiday home will not count. So you have a home in the UK and you have a home in France and you spend 30 days in your French home, then you are in the clear as far as the automatic UK test is concerned. But if HMRC can establish that your home in France is only a holiday home, it will not count as a home (it will be a place to live for the purposes of the UK ties tests—but that does not mean it is a home). If your French property is only a holiday home, then you only have one home for the automatic residence test, and that home is in the UK. You are therefore automatically resident. End of story.

This may cause a few problems—and they will not be resolved until we have some clarity about what is meant by a home. That may take a while.

Costs

Roden v HMRC TC2911 sounds interesting. The taxpayer won his case before the First Tier Tribunal (the tribunal) and was awarded costs against HMRC. However, this may have a sting in its tail.

In general, no costs are awarded at the tribunal unless the case is designated as complex—but even then the taxpayer can opt out of the costs regime. However, the tribunal has power to award costs if one of the parties has acted unreasonably in bringing, defending or conducting the proceedings.

The tribunal said that if HMRC knew that its argument had no reasonable prospect of success it would be acting unreasonably. In this case, taking into account HMRC's resources, it ought to have known its arguments were unsustainable so it was ordered to pay the taxpayers costs.

The tribunal said that although there is nothing wrong in principle in taking novel points of law unsupported by authority, in this case HMRC acted unreasonably in defending the appeal based on a novel point of law which it ought to have known had no reasonable prospect of success.

> *"This is not a get out of jail free card because if the taxpayer has reason to believe that the professional adviser may not be correct, he cannot just close his eyes to those doubts & hide behind the adviser"*

While rejoicing in the success of the taxpayer, this may prove not to be such a great result. Think of all those penalty cases (which dominate the case reports) some of which are hopeless: there must be a risk that they will be affected by this case. Nobody goes to the tribunal to appeal against a penalty of a few pounds without a real sense of grievance and to be lumbered with costs as well, would add to the feeling of injustice.

Void transactions

Earlier this year, the tribunal heard the case of *Russell Baker v HMRC* [2013] UKFTT 394 (TC) which involved transactions undertaken by the taxpayer which were found to be void. As a result, everything had to be unravelled, and despite vigorous efforts by HMRC to salvage its position on the grounds of "economic reality", the tax consequences fell away too.

AC v DC and Others [2012] EWHC 2032 (Fam), [2012] All ER (D) 380 (Jul) deals far more comprehensively

with void and voidable transactions (including transactions set aside under such provisions as s 37 of the Matrimonial Causes Act 1973), and the implications for tax purposes. In this case, the court set aside various transactions by the husband which had been intended to defeat his wife's claims in the divorce. The question was whether the order of the court, that the transactions were void *ab initio,* applied equally for tax purposes.

The court said tax law is not an island. The right for HMRC to charge tax on a particular transaction depends on the effect of that transaction under the general law—unless there is a taxing statute to the contrary.

Longstanding authority of *IRC v Spence* (1941) 24 TC 311 says the tax effects of a transaction are annulled retrospectively if a voidable transaction is declared void—and all the necessary payments and repayments (including tax) must follow this treatment.

For inheritance purposes, s 150 of the Inheritance Tax Act 1984, provides that where a chargeable transfer is set aside as being voidable, the same inheritance tax consequences follow as if the transaction had been void *ab initio*—with a corresponding effect on any subsequent chargeable transfer. There is no similar provision for income tax or capital gains tax and it was suggested that these consequences should therefore not follow for other taxes. For numerous reasons, the court decided that the same principle also applied for other taxes.

This does not seem particularly earth-shattering—it is probably what everybody expected the rules to be. It is perhaps only the development of arguments by HMRC in *Russell Baker* on the basis of "economic reality" which has caused the subject to be revisited.

Residence: distinct break

In *James Glyn v HMRC* TC 3029, Mr Glyn left the UK to take up residence in Monaco in April 2005 and the tribunal had to decide whether he made a distinct break.

As always with residence cases, the decision was crucially dependent on the facts. The tribunal reviewed the facts in exhaustively (conducting the necessary multifactorial evaluation) and concluded that Glyn had made a distinct break from the UK by substantially loosening his social and family ties and therefore become non-resident.

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* [1985] 58 TC 528 which amounts to the same thing. (True, in *Grace v HMRC* [2008] EWHC 2708, Mr Grace won before the Special Commissioners, representing himself, but he went down in flames on appeal.)

The tribunal acknowledged that although Glyn was labouring under a misunderstanding about the meaning of IR20 and 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 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 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. But 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.

These criticisms do not really matter because on the facts, Glyn had made a distinct break, but I imagine HMRC might still want to appeal. It may have a problem overturning the decision which seems to be entirely a question of fact, but we shall see.

Penalties

HMRC is rather keen on penalising people who conduct their tax affairs without due care and attention. The old ideas of negligence and negligent conduct have been replaced by carelessness—and this is defined by Sch 24(3) of the 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 is now pretty clear that where somebody has taken professional advice and relied on it in connection with their affairs, that will protect them from a penalty as they would have taken reasonable care. This has been established in cases such as *Rowland v HMRC* (2006) SpC 548 and *Hanson v HMRC* [2012] UKFTT 95 (TC) and now by *Elizabeth Mariner v HMRC* [2013] UKFTT 657 (TC). HMRC has continued to press this point, mainly I think, to probe the taxpayers conduct to make sure there was no carelessness, even through professional advice had been obtained.

HMRC was emboldened in its approach by the decision in *Wald v HMRC* [2011] UKFTT 183 (TC) 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 is an equally good defence.

The position was reviewed in *Elizabeth Mariner* 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 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 last month: *Stratton v HMRC* TC 2967. The taxpayer had 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 this 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 and possibly goes too far. 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. **NLJ**

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