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UK Tax Bulletin

April 2014

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Introduction

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Latest Rates of Inflation and Interest

The following are the current rates at April 2014

Current Rates	April 2014
Retail Price Index: March 2014	254.8
Inflation Rate: March 2014	2.5%
Indexation factor from March 1982:	
to April 1998	1.047
to February 2014	2.200
to March 2014	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

To 6 April 2014: 4%

From 6 April 2014: 3.25%

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Second Incomes Campaign

HMRC have issued a new disclosure opportunity for individuals to bring their tax affairs up to date where they have not properly disclosed all their income. It is called the Second Incomes Campaign. It applies to people in employment who have another source of income which has not been declared. In principle this is a really good plan – HMRC are so good at finding out about undisclosed income that there is a very powerful message : Tell us about it voluntarily and you will only have to pay a very small penalty – but if we find out about it first, the deal's off and the penalty will be eye watering.

However, there have been so many of these disclosure opportunities that there must be a temptation not to take up this one knowing that another one will come along later. As with all temptations, one must resist – not only to gain moral strength, but because the risks are huge (as demonstrated by the No Safe Havens document issued by HMRC – see below).

To take advantage of this new opportunity, you must tell HMRC that you will be making a disclosure and then send in all the relevant details within 4 months. Interestingly, HMRC ask you to judge how much penalty you think you should pay – and they set out some helpful guidelines. They even suggest that if you submitted a tax return showing insufficient tax because you had been careless, they do not expect to charge any penalty, although you will have to pay tax for earlier years, up to 6 years. If however you have deliberately misled HMRC, either by sending in a tax return knowing the tax was inadequate or failing to tell HMRC about it at all, they indicate that a penalty of 20% of the tax will be appropriate – and you have to go back 20 years.

There is a sting in the tail here. When making the disclosure, HMRC will naturally want to know why you haven't previously told them about the undisclosed income. The reaction of HMRC and the penalties involved will depend upon whether you took reasonable care, whether you were careless or whether the failure was deliberate. On page 10 of the published notes HMRC reveal that if you were eligible for any earlier disclosure opportunity and did not take it, HMRC may find it hard to accept that what you are now disclosing was not a deliberate failure in the past. As the previous disclosure opportunities were extremely comprehensive, it is difficult to think of anything which would not have been included in those disclosure opportunities.

No Safe Havens

HMRC have also published a guidance note entitled No Safe Havens 2014. It has caused a lot of trouble. However, the substantive document looks wholly uncontroversial – indeed it seems to be an excellent summary of how HMRC gain access to information on offshore accounts making it pretty clear that if you have an offshore account, they will find it – and when they do there will be serious consequences with penalties up to 200% of the tax evaded.

Of course there should be criminal penalties for people who evade taxes; that is a crime and should be appropriately punished. So why has it caused trouble? It is because in the Foreword there is a sentence which says that the Government will introduce a new strict liability criminal offence that could mean jail for those who do not declare taxable offshore income.

The two offending words are "strict liability". This means that you are guilty even if there was no intention to commit a crime. The idea of a strict liability criminal offence for which you could be sent to jail is extremely rare – and wholly offensive to anybody with a pulse. You cannot be convicted of

murder, rape, arson or anything else without the prosecution being able to prove your guilt. However, strict liability means that you are guilty and can be sent to prison merely for having money in an account overseas and not telling HMRC. There is no defence and no excuses. Go directly to jail; do not pass GO; do not collect £200. Do we not feel that something has got a bit out of hand here?

I take some comfort from the fact that there is no reference to this aspect within the guidance note but the Treasury press release is not very encouraging. They explain that HMRC are hampered by the fact that to obtain a criminal conviction they have to prove that the taxpayer has committed a crime. Lordy!

They explain that with these new rules "it will be easier to secure successful prosecutions". Er, yes; of course it will be miles easier. If you can get a conviction without having to prove that anybody has committed a crime it will be a doddle.

Should we check the date. Was it issued on 1 April. No – it was 14 April. So presumably there is somebody in HMRC on secondment from Mars (or North Korea) who thinks this is sensible.

Management Expenses : Guarantees

The recent case of *Howden Joinery Group Plc v HMRC TC 3396* was mainly about a deduction for management expenses but had a much more interesting element concerning payments under a guarantee.

The Tribunal confirmed the distinction between the expenses of management of the company and the expenses of management of the company's investment business. This is a very fine distinction and the Tribunal concluded that the provision of a guarantee by a parent company to a subsidiary (for the benefit of both parties) was expenditure on an asset of the parent rather than on its investment business.

The guarantee question was mainly concerned with the character of a payment made under a guarantee. The company had guaranteed the rent of another company so did the payments under the guarantee have the character of rent or did they have an independent character being guarantee payments?

Interestingly the Greek Bank case (*Westminster Bank Executor and Trustee Co v National Bank of Greece (1971)*) makes another appearance as it was not only concerned about withholding tax (see last month) but also on the issue of payments under a guarantee. In the Court of Appeal it was said:

> "*The guarantors unconditionally guaranteed the due payment of the principal and interest. When they pay under the guarantee, they pay the interest which the principal debtor should have paid. The indebtedness for interest is then discharged. So the payment is truly payment of interest.*"

On appeal to the House of Lords the question of the treatment of the guarantee payments did not arise because the point had been dropped but there was nothing said in the House of Lords to cast any doubt on the judgment of the Court of Appeal on this point.

This reasoning was supported by the subsequent case of *Hawkins v Hawkins (1972)* which held that the guarantor paid what he promised to pay, namely principal and interest, and that the difference in the source of the obligations did not affect the nature and quality of the thing paid.

Nevertheless, the Tribunal concluded that the Greek Bank case was not clear authority for the fact that the guarantee payments follow the character of the payments which they replaced and they came to the opposite conclusion.

This leaves us in some difficulty. We have a clear explanation of the position from the Court of Appeal followed by an equally clear judgment in the High Court - but an opposite conclusion from the First Tier Tribunal. As the First Tier Tribunal judgments are not binding on anybody but the parties, it probably does not change anything, but it is far from satisfactory.

IHT : Partnerships

In January I mentioned a technical note issued by the Tax Faculty of the Institute of Chartered Accountants following discussions with HMRC relating to business relief and partnerships where a company is involved. It set out the views of HMRC on the matter with admirable clarity – even if those views might be regarded as extreme, and possibly contrary to the will of Parliament. This was ironic because HMRC are keen to criticise any interpretation of legislation which is in their view inconsistent with the will of Parliament.

It is therefore interesting and helpful to read in Taxation magazine that James Kessler takes the view that some of the conclusions of HMRC are simply wrong.

HMRC say that business property relief is not applicable to an interest in a partnership or LLP which owns shares in an unquoted trading company even if the shares in the company would otherwise have qualified for relief if held directly. They say that partnerships are not transparent for IHT purposes and it is necessary to consider the actual business of the partnership. If the partnership business consists wholly or mainly in holding shares in unquoted companies (even unquoted trading companies) relief is not available.

However, James Kessler draws attention to Section 104(1) IHTA 1994 which provides that:

> "*Where the whole or part of the value transferred by a transfer of value is attributable to the value of any relevant business property, the whole of that part of the value transferred shall be treated as reduced*."

It is therefore argued that we have to consider not whether the partnership is transparent, but whether the value of the partnership interest is attributable to the value of any relevant business property. Plainly it is. It is attributable to the value of the unquoted trading company.

Support for this conclusion is clearly found from the case of *HMRC v Nelson Dance [2009] ASTC 802*.

James Kessler's compelling analysis is extremely welcome not least because it would seem to correct an HMRC approach which is both unfair and capricious – but also because it provides grounds to challenge HMRC's approach on this subject, should the problem arise.

IHT : Relevant Property

I was interested to read the case of *Gilchrist v HMRC FTC/89/2012* in which it was confirmed that the Upper Tribunal is not bound by decisions of the High Court. The Upper Tribunal is a superior court of record and is in the same position as the Employment Appeals Tribunal. It may therefore depart from decisions of the High Court if the Tribunal is satisfied that the earlier decision of the High Court was wrong.

The main issue in Gilchrist concerned whether the proceeds of a scrip dividend were income or capital for trust law purposes – and therefore whether they were subject to the 10 year charge to inheritance tax in the hands of the trustees. This is not an issue of much general relevance but it is perhaps interesting to know that although a scrip dividend is income for income tax purposes, that does not mean it is income for trust law purposes.

Income can of course be accumulated and become capital, but that was not the issue here. The question was whether the scrip dividend proceeds were capital as a matter of law. The Tribunal decided that they were. The proceeds were part of the trust capital and represented relevant property for the purposes of inheritance tax – and were therefore subject to the 10 year charge on each 10 year anniversary (and of course exit charges in the meantime).

Capital Allowances

We have not had any tax cases about capital allowances for a while - certainly not on the once popular theme of whether expenditure is on plant, or on the setting in which the trade is carried on.

Accordingly, it was interesting to read the case of *Rogate Services Limited v HMRC TC3449* in which the question was whether expenditure on a car valeting bay was plant and eligible for capital allowances.

The Tribunal found as a question of fact that the expenditure was on a building. This is hardly surprising because the company sought planning permission for the erection of a double garage and the expenditure was incurred on walls, a floor, a ceiling and a roof. It sounds like a bit of a stretch to argue that this was not a building. The taxpayer claimed that it could still qualify as plant as it fulfilled an active function as it was used to apply glass coat finishes to cars.

The Tribunal concluded that this particular building did not perform a function. It was a place of work which did not amount to plant.

This sounds like a close run thing. In this building the relevant process took place for the application of the glass coats to the cars. Was that an active function? The taxpayer may have taken comfort from:

- *Cooke v Beach Stations Caravans* where a swimming pool provided an active function of "pleasurable buoyancy" for bathers
- *Schofield* where a silo provided an active function of holding grain
- *Andrew* where a gazebo provided facilities for customers to sit and drink

all of which were held to be plant.

However, in *Burnley Football Club*, expenditure on a stand where people were able to sit and watch the game was not plant although in *Roscommon Race Committee* a race course stand where people were able to sit and watch was plant. (This also contrasts with *St John's School* where a gym was said not to have a functional purpose. Presumably sitting and watching is a functional purpose but carrying on gymnastic activity is not.)

In *Benson v Yard Arm Club* a floating restaurant did not fulfil an active function although it is difficult to see why pleasurable dining is significantly different from pleasurable swimming.

Similarly in *Anduff* a car wash was held not to fulfil an active function. My experience of car washes is not great, but I understand that they do a number of things actively (like wash, brush, clean and dry your car) which sounds a tad more active than merely holding grain.

Having regard to all the above, the taxpayer might have thought that his expenditure on the building might be OK. However, I think the answer can be found from Sections 21 and 22 Capital Allowances Act 2001 which post date all the above decisions.

Section 21 provides that expenditure on the provision of plant or machinery does not include expenditure on the provision of a building. Furthermore, Section 22 provides that expenditure on provision of plant and machinery does not include expenditure on the provision of a structure.

Accordingly, it would not seem to matter any more that the building fulfils an active function. If it is a building or a structure (other than those specifically excluded) it is disqualified from being plant and that is the end of the matter.

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