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UK Tax Bulletin

May 2015

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Introduction

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Latest Rates of Inflation and Interest

The following are the current rates at May 2015

Current Rates	May 2015
Retail Price Index: April 2015	250.0
Inflation Rate: April 2015	0.9%
Indexation factor from March 1982:	
to March 2015	2.236
to April 2015	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%

To 6 April 2015: 3.25%

From 6 April 2015: 3%

HMRC Enquiries

The recent case of *Mathew v HMRC TC 4342* involved appeals against Schedule 36 Notices and covered a great deal of ground. However, two interesting features emerged as part of the discussion in the Tribunal.

The first related to the burden of proof. Mr Mathew said that the burden of proof was on HMRC to show that the information and documents requested by the Schedule 36 Notice were "reasonably required". This looked like a pretty good argument because of the case of *Kevin Betts v HMRC (2013)* where it was common ground that the burden of proof was on HMRC.

It is therefore a bit odd that in this case, HMRC argued that this was wrong and said that the burden of proof was on the taxpayer. There were various authorities in support of the view taken by HMRC and the Court held that there was a presumption that the statutory authority (HMRC) has acted lawfully and in accordance with their duty – and therefore the burden must be on the other party to rebut this presumption.

Clearly the point is arguable – but it does rather raise the question why in 2013 HMRC argued to the contrary.

Without wanting to be too cynical, both the taxpayer and HMRC now have the opportunity to argue whatever they want because each can point to a Tribunal decision in favour of either view. I am not sure that the system is supposed to work like that.

A further interesting aspect was a clear statement by the Tribunal that HMRC are not permitted to use Schedule 36 as a fishing expedition. We all know this of course (in principle) but it is extremely helpful for the Tribunal to say it so clearly. The FTT set out a relevant extract from the case of *R v HMRC ex parte Ulster Bank Limited (1997)* in which it was said that:

> *"HMRC may not use their Schedule 36 powers for a fishing expedition … a broadly drafted request will not be valid if in reality HMRC are saying "can we have all available documents because they form so large a class of documents that we are bound to find something useful". What is required is that the request is genuinely directed to the purpose for which the Notice may be given, namely to secure the production of documents reasonably required for carrying out an investigation or enquiry of any kind into another taxpayer's tax position."*

This can obviously be useful in the event of piscatorial excess by HMRC, but I expect that imaginative drafting by HMRC should be able to get over most areas of opposition.

Entrepreneurs Relief : Underwriters

The recent case of *Carver v HMRC TC 4362* contains an interesting discussion on the concept of an underwriting trade and the nature of "syndicate capacity". Syndicate capacity is the extent to which a syndicate may underwrite insurance business i.e. the maximum amount of premium income that it may accept. This will be equal to the total of the premium limits of all the syndicate members.

Mr Carver was carrying on a trade as a Name at Lloyds. He participated in 18 syndicates and sold some syndicate capacity in one syndicate giving rise to a capital gain. He retained syndicate capacity in the other syndicates. Mr Carver claimed that he was entitled to entrepreneurs relief in respect of this capital gain because it was a separate and identifiable part of the business and represented the disposal of part of his business under Section 169I(2) TCGA 1992.

Alternatively, Mr Carver argued that each syndicate represented a separate business so that the

sale of his capacity in the relevant syndicate was the sale of that business.

Mr Carver also observed that HMRC accept that Entrepreneurs Relief is available when a person sells all his syndicate capacity, so this is just a question of degree.

HMRC said that the part of the business disposed of must be a viable part of the composite trade that would still be recognised if it were separated from the whole.

The Tribunal decided that the economic activity was the underwriting business, not the holding of syndicate capacity. A Name at Lloyds carries on a single trade however many syndicates are involved. The syndicate capacity was the means by which his trade was carried on and although it was an asset of the trade (similar perhaps to goodwill) it was not a trade itself. Accordingly, the gain could not qualify for entrepreneurs relief.

Such a disposal might be thought to represent an associated disposal being a disposal associated with his withdrawal from the business but clearly that did not occur in this case. More importantly, for the relief to apply to an associated disposal under Section 169K TCGA 1992 the business has to be carried on by a company or a partnership. It does not apply to a sole trader.

Tax Harmonisation

I rarely stray into such policy areas but I was interested to read a recent opinion of the CFE ECJ Task Force regarding some ECJ decisions on inheritance tax – ECJ TF1/2015.

Personally I find documents emanating from the ECJ to be seriously difficult to understand – you have to be really determined. Anyway, what this opinion says is that there is no harmonisation of inheritance taxes within the EU. Some states impose an inheritance tax, others do not, and some do it in an unlawfully discriminatory manner. The idea of “ever closer union” certainly has some way to go on the area of inheritance tax.

The significance here is that the ECJ have said that the inheritance tax in Spain and the inheritance tax equivalent in Germany, both violated EU law. Both taxes have been challenged before and both Governments have made amendments to their inheritance tax regime but the opinion explains that neither have gone far enough to remedy the unlawful position.

Obviously this is an enormously complex area and we cannot assume too much from this opinion, but I am sure it will be very helpful indeed for anybody involved with an estate containing property in Germany or Spain.

Share Valuation

The recent case of *Foulser v HMRC TC 4413* involved a lengthy judgement by the First Tier Tribunal on a valuation of some unquoted shares for capital gains tax purposes. The shareholdings were very different – one being 51% and the other being 9%.

The Tribunal went through the statutory requirements of Sections 272 and 273 TCGA 1992 and explained all the artificial considerations which are necessary in a valuation of shares for fiscal purposes. There is a hypothetical (and willing) seller; a hypothetical (and willing) prospective purchaser who is a prudent man of business, a sale in the open market and the availability of reasonable information – as well as the existence of a special purchaser.

The case involved contrasting valuations by the taxpayer and HMRC with conflicting expert valuations as well.
The Tribunal sorted it all out and effectively took what they thought to be the best bits from each of

the experts valuation to reach their own conclusion on the matter. Inevitably the decision is heavily fact dependent but one or two interesting features emerged. For example it was suggested that the minority discount applicable to a 51% shareholding should be in the region of 20%. That seems uncontroversial and consistent with prevailing practice but strangely, they said that the minority discount for the 9% valuation should be only 50%. Given that a 51% shareholder controls the entire company (OK, they cannot pass a Special Resolution, but they are in full control of everything else) and if a 20% minority discount is applicable to a 51% holding, one would have thought that a rather higher than 50% discount would be applicable to a 9% holding where the shareholder has no effective rights whatsoever and must just sit and hope that nice things happen. My experience is that a 9% holding would generally involve a discount of 75% or so. Indeed I would observe that in *Caton v Couch (1995)* HMRC argued that a discount of 60-70% was appropriate to an uninfluential minority holding, which certainly looks closer to normal practice.

The Tribunal had more to say about this 9% holding because the taxpayer claimed that it should be valued on the basis of a dividend yield. However, the Tribunal said that a dividend yield basis is not appropriate if there is no prospect of a dividend being paid. This seems a little odd because I thought that *Salvesen's Trustees v IRC (1930)* was authority for the view that what matters is not the actual dividends paid but the maintainable dividend which is capable of being paid from the maintainable earnings. Otherwise you have the absurd situation that a small minority holding in a company which makes £10 million a year is worth very little if they choose to pay no dividends, but worth a great deal if they do pay dividends. (That would be good – especially if you are one of the shareholders who can determine whether or not dividends are paid.) The idea of a dividend yield basis is to make sense of all this (particularly in the hypothetical environment in which fiscal share valuations take place) by looking at the dividends which are capable of being paid by the company, taking into account distributable profits, cover, cash resources and commitments, so that there is a better chance of ending up with consistent valuations.

The Tribunal went on to explain what I thought was the reason why they rejected a dividend yield approach, which was because there had been a number of bid approaches. (It is perhaps relevant to consider whether this would have been information known to a 9% shareholder – but never mind that for the moment). The possibility of a sale of course makes all the difference. One of the reasons why a minority discount is appropriate is because of unmarketability – the inability for the minority shareholder to realise his investment. However, if there is a bid on or near the table, the prospect of a sale eliminates much of the reason for a discount for unmarketability and the Tribunal indicated that this was clearly a relevant consideration to be taken into account.

In principle, that sounds unarguable, except that at the end of the judgement the Tribunal found that a prudent prospective purchaser would not have regarded the relevant offer as likely to succeed. That would seem rather to undermine the basis put forward for the valuation of the 9% minority holding.

Another interesting aspect was the use of PE ratios in connection with the valuation of unquoted shares. The expert for HMRC said that a comparison which quoted PE ratios should be made; the expert for the taxpayer said it should not - and the Tribunal came to yet another conclusion. This is all a bit unsatisfactory because comparisons with the quoted sector are not generally regarded as appropriate and this was certainly the view of the Courts in such celebrated cases such as *Lynall* and *Holt*.

This judgment has lots which will be relevant and useful to anybody interested in the subject and well worth a read.

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Equitable Mistake

The decision of the Supreme Court in *Pitt v Holt [2013] UKSC 26* was pretty much the last word on mistake and on the limits of the Hastings Bass principle.

In the Autumn, the case of *Wright v Nat West Bank Plc* reviewed the guidance from the Supreme Court in deciding whether they were able to exercise their discretion to rescind a disposition on the basis of a unilateral mistake. The High Court said that such a mistake cannot be a pure question of fact nor can it have arisen out of inadvertence or ignorance. The causative mistake must be so grave that it would be unconscionable for the Court to refuse relief.

The High Court has again considered this principle (and in particular the observation of Lord Walker who in 2002 wondered why the Courts, rather than the parties professional indemnity insurers, should have to pick up the pieces when a mistake had been made).

In the case of *Freedman v Freedman & Others [2015] EWHC 1457*, Mr Freedman settled money on his daughter (not for any tax purpose, but purely for personal and family reasons) having been advised that no inheritance tax liability would arise because of the life interest of his daughter. Unfortunately, the advice had overlooked that since 2006 such a gift would be a lifetime chargeable transfer giving rise to an immediate 20% charge. This had such a serious effect on the family's financial situation and their relationships that the High Court thought this was properly described as grave. The settlement was created primarily for the protection of his daughter rather than the other beneficiaries. The large tax liability which arose was extremely serious and the Court decided it would be unconscionable for the other beneficiaries to profit from this mistake and the settlement was accordingly set aside on the grounds of equitable mistake.

This does not break new ground, but confirms the principles established by the Supreme Court in *Pitt v Holt* which are life saving in the right circumstances. HMRC opposed the application not it seems out of any particular wish to disadvantage the applicant, but just to ensure that all the relevant arguments were fully articulated before the Court.

Tax Awards

I would like to thank all those readers whose support caused me to win the Tax Writer of the Year award at this year's Taxation Awards. I do not know who they were– but I am extremely grateful.

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