SQUIRE PATTON BOGGS

UK Tax Bulletin

September 2015

SQUIRE PATTON BOGGS

Introduction

Latest Rates of Inflation and Interest

The following are the current rates at September 2015

Current Rates	September 2015
Retail Price Index: August 2015	259.8
Inflation Rate: August 2015	1.1%
Indexation factor from March 1982: to July 2015 to August 2015	 2.255 2.270

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%

SQUIRE
PATTON BOGGS

Domicile Paradox

The Chancellor's proposals regarding the taxation of foreign domiciled individuals have caused a bit of a flurry. Further details are set out below, but one interesting development is the following paradox.

There are a number of people who have a foreign domicile but who have been living in the UK for some time. Their period of residence in the UK may have caused their long term residential intentions to become a little clouded and HMRC may well take the view that they have acquired a UK domicile of choice by residing here with the intention of residing here permanently or indefinitely.

Similarly, there will be some who have acquired a foreign domicile of choice but happen to be residing in the UK for some temporary domestic or work reason. HMRC might suggest that they have ceased to reside in their home territory, and no longer have any genuine intention to return there and have therefore lost their domicile of choice.

The proposals have had the effect of concentrating the mind and for some, the tax consequences will be so awful that they are now certain that they will not be staying in the UK.

The Chancellor has effectively made up their mind for them and they will definitely be leaving so any opportunity HMRC may have had to challenge their domicile on the grounds of the uncertainty of their future residential intentions will be lost.

The law of unintended consequences is clearly alive and well.

Non Doms

Following the announcement in the Budget on 8 July and the detailed technical notes on the new tax treatment of non doms, the professional bodies have done a really good job in highlighting a number of difficult areas which need to be addressed, some of which are going to be considered by HMRC. Details of the proposals were set out in detail in the July Bulletin.

The eagerly awaited consultation document appeared on 21 September (although it disappeared mysteriously almost immediately but reappeared today). This document takes us a little further – although it raises more questions which will not be resolved until we see the Finance Bill 2016.

The technical briefing note issued on Budget Day referred to the new deemed domicile rule which will apply where an individual has "been resident in the UK for **more than 15** out of the past 20 tax years". The consultation document says:

> "*At Summer Budget 2015, the Government announced that it would treat any individual who has been resident in the UK for* ***at least 15*** *out of the past 20 tax years as deemed UK domiciled for tax purposes.*"

No it didn't. This is not the same thing at all. "More than" 15 years is not the same as "at least" 15 years. This is not slack wording; the rest of the document (including the draft clauses) make it clear that this is a policy change.

In counting these years it is intended to include any year in which the individual is resident for any part of the year – by application of the split year rules. (My heart sinks – the split year rules are so fiendishly complicated that it is going to be really difficult to reach a reliable conclusion in any particular case).

The new rules will mean that an individual who is domiciled in the UK and acquired a domicile of choice in another country could become non domiciled for inheritance tax more quickly than an individual who only has a deemed UK domicile. This is because an individual who ceases to be domiciled in the UK continues to be treated as UK domiciled for a further 3 years whereas if they are deemed domiciled under the 15 out of 20 year rule, they would have to be non resident for 6 years. HMRC recognised this would be unreasonable – and the answer (of course) is that there will be a 6 year rule for everybody.

It may be remembered that HMRC are developing a principle that somebody with a UK domicile of origin who acquires a foreign domicile of choice will lose all non dom privileges for any period that they are UK resident. This is seriously capricious and it is to be hoped that the result of the consultation will mean it is watered down. This may not be a forlorn hope because there is a suggested “grace period” for IHT so that the full impact of being deemed domiciled for IHT will not apply in the first year of UK residence – but only from the second year.

Strangely, it will apply only to individuals who are born in the UK with a UK domicile of origin. I am sure they are aware that where you are born has nothing to do with your domicile of origin – your domicile of origin usually being determined by the domicile of your father at the date of your birth. However, this will exclude from the scope of this new rule those with a UK domicile of origin who happen to have been born outside the UK. Again this is no accident. The rest of the document makes it quite clear that this is the intention. Maybe this is just a way to avoid HMRC having to engage in a whole lot of really difficult arguments.

One of the unfortunate implications will be the position relating to trustees who may at the moment be protected from IHT on the basis that the trust assets are excluded property. If the settled property loses its excluded property status, the trustees will be exposed to a charge to tax.

Let us assume that somebody with a UK domicile of origin becomes domiciled in another country and establishes an excluded property settlement. If for any reason they find themselves resident in the UK (perhaps returning for a short period to attend to elderly parents, or perhaps were sent to the UK to work on a short assignment) they would find themselves fully chargeable to UK tax on everything without regard to their non dom status. And if their period of UK residence happens to coincide with a 10 year anniversary of their trust, there will be a 10 year charge because the trust will no longer contain excluded property.

What is worse is that somebody who becomes UK resident in these circumstances would then continue to be within the inheritance tax net (and so would the trustees) for a further three years (and possibly six years) after his departure. There may be some apportionment provisions but that would not stop this being an awful (and unjustifiable) trap which ought not to form part of any sensible tax code.

Goodness me, there is going to be a lot of activity between now and April 2017.

Stay tuned.

CGT : Private Residence Exemption

The recent case of *Fountain v HMRC TC 4596* was concerned with the application of the main residence exemption to the sale of land which Mr and Mrs Fountain claimed formed part of the garden or grounds of their main residence.

The Tribunal found as a fact that the land never formed part of their garden so it could not possibly benefit from the exemption but the remainder of the decision raises some issues.

HMRC argued (and persuaded the Tribunal) that to qualify for the relief, the garden must be owned together with the residence at the date of disposal. This idea has its origins in the case of *Varty v Lynes 51 TC 419* where the Court suggested that if the taxpayer ceases to occupy the house before he sells it, the exemption will be lost in respect of the garden. This is a serious issue because, of course, it will often be the case that a person will move out of his house before he sells it, which is why the legislation allows a period of 18 months between moving out and selling the property, without any loss of the exemption. It would be extraordinary if this applied to the house, but not the garden.

Indeed, as long ago as 1976, HMRC accepted that this was too restrictive an interpretation (and did not form part of the judgment anyway) and confirmed that this is not their view. The HMRC Manuals say that the judgment:

> "… *may be interpreted incorrectly as meaning that if the owner of a dwelling house is not physically present in it at the date of sale, there can be no relief on a disposal of the garden…. It is our view that relief would not be lost in these circumstances.*"

Although it may have made no difference to the outcome as the relevant land had never been part of the taxpayer's garden, it is odd that the established HMRC view on the matter conflicted so comprehensively with their submissions before the Court.

IHT Residence Relief

The new £175,000 inheritance tax relief on main residences announced in the Budget has been mentioned in earlier Bulletins but we now have some more details. (Actually the relief does not only apply to main residences but applies to any residence nominated by the executors. Nor is it £175,000; that only comes in in 2020, but never mind.) The relief is still confined to those with estates of less than £2 million.

HMRC have published guidance about how it will be applied to people who downsize to a less valuable property, or indeed dispose of the property altogether and go into residential care. In these circumstances, the relief will not be forfeited – and it will even apply to the garden or grounds.

HMRC explain that on the disposal of the residence there may be a potential loss of the chance to use a proportion of the extra relief which might otherwise have applied in the event of a death. The relevant proportion of the potentially lost relief can be applied to the available relief on death (possibly including the part transferred from the spouse). I am glad they have made this clear.

I think that we have got the general idea despite the fact that it is virtually impossible to understand how it will actually apply in practice. Anyway, we should be grateful for this additional relief even though comprehension may take a while.

Taxable Profits and GAAP

My understanding of this issue was that a pretty clear principle had been established i.e. that the taxable profits of a trade are determined in accordance with Generally Accepted Accounting Principles – subject of course to some specific statutory exceptions such as depreciation, entertaining expenses and similar items which are not deductible for tax purposes on policy grounds.

It is therefore interesting to read the case of *GDF Suez Teeside Limited v HMRC TC 4590* where HMRC argued that the profits shown in the accounts of the company prepared in accordance with GAAP should not be the proper determinant of their taxable profits – not because there was any statutory disallowance but because the accounts prepared on this basis did not “represent a fair view of the profits”.

I think that professional accountants (and the Financial Reporting Council) will be horrified by the suggestion. All accountants know (from their mother’s knee) that a “true and fair view” is fundamental to accounting in the UK. Indeed it is a requirement of the Companies Act 2006 and EU law.

The Tribunal confirmed that if the accounts are in accordance with GAAP, HMRC cannot choose a different accounting treatment which they prefer. If the accounts are GAAP compliant, they have to be accepted.

However, the Tribunal went on to say that although the accounts of GDF Suez were GAAP compliant, they did not give a fair representation of the profits and determined that the profits should be some other figure.

This seems to give rise to a whole new principle. The taxable profits of a company are no longer to be determined by accounts properly prepared in accordance with GAAP; the taxable profits are to be determined by the Tribunal. Having regard to the history of this issue and the weighty authorities on the matter, this would appear to be a tad revolutionary.

The issues were complex and involved a tax avoidance scheme but it is difficult to see why that should make any difference to the analysis. It might be suggested this is a special case and the general rule still applies, but the whole point of GAAP is consistency – not to have profits determined on a case by case basis.

I have little doubt that the amounts involved and the importance of the issue will mean that further judicial guidance on this issue will be forthcoming before too long.

Travel to Work

I have been reading the recent EU Case 266/14 (as you do) where the Court considered whether an employee was working (and should therefore be paid) when he was travelling from home to work.

The EU Court decided that the employee was entitled to be paid for this travelling time. Essentially the reasoning was that the employee was not in a position to use his time freely and pursue his own interests whilst he was travelling. Furthermore, in this case the employer had moved the place of work to another city so that the employee had a longer journey. The employee therefore lost the ability to determine the distance between home and work and therefore the start and finish of his working day. The Court said that he should not be required to bear the burden of the employer’s choice to move the offices.

This case was all to do with health and safety and other things (nothing to do with tax) but it seemed to me to have a tax resonance.

We know from numerous authorities that the cost of travelling to and from work is not deductible because the employee is not performing his duties during the journey – he is getting to the place where he is required to perform his duties (see *Ricketts v Colquhoun 10 TC 115*). Similarly it has been said that the travelling is dictated by the employee’s own choice of where he lives (see *Warner v Prior SpC 353*). Again in *Lewis v HMRC*, when travelling the employee was said to be travelling *to* her work and not *on* her work.

It seems possible that these principles could be affected by this EU decision. If the time travelling is working and deserves to be paid, then it must surely follow that the expense of travelling should be deductible. A fortiori where the employer moves the offices and increases the employee's journey time.

The analysis gets a bit confused by the statutory rule in Section 338 ITEPA 2003 relating to ordinary commuting, but there still seems to be an important issue here.

I do not suppose it will come to anything but it is interesting to think that this long standing tax principle might be capable of challenge in the light of this decision.

P S Vaines
Squire Patton Boggs (UK) LLP
30 September 2015

Contact

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